Final Statement of Reasons for the Re-Adoption of California Code of Regulations, Title 18, Section 474, *Petroleum Refining Properties*

Update of the Information Contained in the Initial Statement of Reasons

The factual basis, specific purpose, and necessity for, the problem to be addressed by, and the anticipated benefit from the Board's re-adoption of California Code of Regulations, title 18, section (Rule) 474, *Petroleum Refining Properties*, are the same as provided in the initial statement of reasons. The Board anticipates that the re-adoption of Rule 474 will clarify the treatment of petroleum refinery property for purposes of measuring declines in value, and thereby benefit county assessors and the owners of petroleum refineries by promoting fairness and uniformity in the assessment of petroleum refinery property throughout the state.

The re-adoption of Rule 474 is not mandated by federal law or regulations. There is no previously adopted or amended federal regulation that is identical to Rule 474.

The Board did not rely on any data or any technical, theoretical, or empirical study, report, or similar document in proposing the re-adoption of Rule 474 that was not identified in the initial statement of reasons, or which was otherwise not identified or made available for public review prior to the close of the public comment period.

The Board held a public hearing on December 18, 2014, regarding the re-adoption of Rule 474. The Board received and considered public comments supporting the factual basis for the Board's re-adoption of Rule 474 and the Board's assessment of the economic impact of the re-adoption of Rule 474, which are quoted below. The Board also received and considered public comments opposing the re-adoption of Rule 474 and the Board's assessment of the economic impact of the re-adoption of Rule 474, which are responded to below. Most of the comments opposing the Board's re-adoption of Rule 474 are quoted in their entirety below. However, some of the comments, particularly some of the comments in the 15-page letter from Ms. Catherine H. Reheis-Boyd, are summarized or partially quoted below.

Page 8 of the initial statement of reasons provides that the Board received an August 20, 2013, letter from Sharon Moller, the Chief Deputy Assessor for the Los Angeles County Assessor's Office, and "[i]n the letter, Ms. Moller explained that the California Supreme Court's opinion in [*Western States Petroleum Association v. Board of Equalization* (2013) 57 Cal.4th 401 (hereafter *WSPA v. BOE*)], which upheld the substantive validity of Rule 474, but still invalidated the rule on procedural grounds, created an issue (or problem within the meaning of Gov. Code, § 11346.2, subd. (b)(1)) for county assessors in counties with petroleum refinery property as to:

- Whether petroleum refinery land, improvements, and fixtures constitute a single appraisal unit for determining declines in value, under [Revenue and Taxation

Code (RTC)] section 51 and the substantive policy expressed in Rule 474, because petroleum refineries are commonly bought and sold as a unit in the marketplace; or

- Whether petroleum refinery fixtures constitute a separate appraisal unit, as provided in Rule 461, subdivision (e) (hereafter Rule 461(e))."

Page 10 of the initial statement of reasons provides that the "Board determined that it is reasonably necessary to re-adopt Rule 474 for the specific purpose of addressing the issue (or problem) identified in Ms. Moller's August 20, 2013, letter by clarifying that petroleum refinery land, improvements, and fixtures are rebuttably presumed to constitute a single appraisal unit for determining declines in value because petroleum refineries are commonly bought and sold as a unit in the marketplace." And, the public comments in support of the Board's re-adoption of Rule 474 (quoted below) provide further support for the Board's determination that it is necessary to re-adopt Rule 474 to address the issue (or problem) identified in Ms. Moller's letter. Therefore, at the conclusion of the December 18, 2014, public hearing, the Board voted to re-adopt proposed Rule 474 without making any changes.

In addition, the public comments in support of the Board's re-adoption of Rule 474 provide further support for the Board's conclusion, on page 13 of the initial statement of reasons, "that persons in the marketplace still commonly buy and sell operable California petroleum refineries as a unit, just as they did when the Board first adopted Rule 474." And, the public comments opposing the re-adoption of Rule 474 do not provide any information that would tend to indicate that the marketplace for operable California petroleum refineries has substantially changed in any relevant way since the Board first voted to adopt Rule 474 in 2006 and since the California Supreme Court decided *WSPA v. BOE* in 2013.

Moreover, the public comments in support of the Board's re-adoption of Rule 474 provide further support for the Board's conclusion, on page 14 of the initial statement of reasons, that "the re-adoption of Rule 474 is fully consistent with the existing mandates of RTC section 51(d), and that there is nothing in the proposed re-adoption of Rule 474 that would significantly change how individuals and businesses, including county assessors and petroleum refinery owners, would generally behave due to the current provisions of RTC section 51(d) as interpreted by the California Supreme Court in *WSPA v. BOE*."

Furthermore, the factual basis has not changed for the Board's determinations on pages 14 and 15 of the initial statement of reasons that:

- "[T]he re-adoption of Rule 474 does not impose any costs on any persons, including businesses, in addition to whatever costs are imposed by RTC section 51(d) as interpreted by the California Supreme Court in *WSPA v. BOE*, and there is nothing in Rule 474 that would impact revenue";
- "The . . . re-adoption of Rule 474 will not have a measurable economic impact on individuals and business, including county assessors and petroleum refinery

owners, that is in addition to whatever economic impact the enactment of RTC section 51(d), as interpreted by the California Supreme Court in *WSPA v. BOE*, has and will have on individuals and businesses";

- "[T]he proposed re-adoption of Rule 474 is not a major regulation, as defined in Government Code section 11342.548 and California Code of Regulations, title 1, section 2000";
- "[T]he proposed re-adoption of Rule 474 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California";
- "[T]he re-adoption of Rule 474 will not affect the benefits of Rule 474 to the health and welfare of California residents, worker safety, or the state's environment"; and
- "[T]he re-adoption of Rule 474 will not have a significant adverse economic impact on business."

And, the public comments in support of the Board's assessment of the economic impact of the re-adoption of Rule 474 provide further support for these determinations.

Finally, the Board included a statement on page 15 of the initial statement of reasons that "[t]he proposed re-adoption of Rule 474 may affect small businesses" because the Board had not conclusively determined that the re-adoption of Rule 474 could not possibly have some minor unforeseen effect on small business at the time the Board prepared the initial statement of reasons. However, no interested parties identified any impact the Board's re-adoption of Rule 474 would actually have on small business prior to the Board's re-adoption of Rule 474.

Public Comments in Support of Re-Adopting Rule 474, the Board's Response to the Recommendations that the Board Re-Adopt Rule 474 to Reduce Potential Litigation, and Discussion of the Comments Regarding the Application of the Rebuttable Presumption in Rule 474

Comments from Los Angeles County

The Board received a letter dated December 9, 2014, from Mr. Jeffrey Prang, Los Angeles County Assessor, in support of the Board's re-adoption of Rule 474 and the Board's assessment of the economic impact of re-adopting Rule 474. Mr. Prang's letter provides as follows:

> The Los Angeles County Assessor's Office wishes to reiterate its support for the State Board of Equalization's pursuit to re-adopt California Code of Regulations, title 18, section (Rule) 474, *Petroleum Refining Properties*. As the home of six of the eleven large petroleum refineries in the State of California, we advocate the Board's efforts to promote fairness and uniformity in the assessment of petroleum refineries in the State for the purpose of measuring declines in value.

Rule 474's original adoption was ruled procedurally invalid by the California Supreme Court in *WSPA v. BOE* solely because the Board failed to provide an adequate statement of economic impact as required by the Administrative Procedure Act. More importantly, the Court affirmed the policy enacted in Rule 474 that the performance of "decline-in-value" appraisals of petroleum refinery properties should be based on the unit that persons in the marketplace commonly buy and sell. This market based approach ensures that reductions in property values are measured according to fair market value.

Land, improvements and fixtures and other machinery and equipment classified as improvements for a petroleum refining property are rebuttably presumed to constitute a single appraisal unit for determining declines in value because petroleum refineries are commonly bought and sold as a unit in the marketplace. Rule 474 still allows assessors the flexibility to consider evidence that shows that land, improvements and fixtures did not transfer as an economic unit when such circumstances present themselves.

Rule 474 is consistent with current assessment practice being employed in the County of Los Angeles. The re-adoption of Rule 474 would clarify for county assessors that petroleum refinery land, improvements and fixtures constitute a single appraisal unit which is consistent with RTC section 51 (d) as opposed to petroleum refinery fixtures constituting a separate appraisal unit as provided in Rule 461.

Los Angeles County Assessor's Office has provided economic data to the Board to assist it in completing the economic impact assessment. We believe the Board's assessment as reflected in the Initial Statement of Reasons is in accordance with the APA and *WSPA v. BOE.* The study makes a reasoned estimate of all the cost impacts of the proposed rule on the affected parties.

In conclusion, we support the re-adoption of Rule 474 which will assist assessors by clarifying the appraisal unit to be used when valuing petroleum refining properties for declines in value. This practice is consistent with what is observed in the marketplace and has been affirmed by the California Supreme Court. The economic impact assessment has been completed as required by the APA and *WSPA v. BOE*.

We appreciate the Board taking steps to proceed with the readopting of Rule 474. My Office stands ready to advocate in support of this action and to provide expert testimony in this process.

Mr. Albert Ramseyer, Deputy County Counsel for Los Angeles County, appeared at the public hearing on December 18, 2014, on behalf of Mr. Prang and provided the following

testimony in support of the Board's re-adoption of Rule 474:

> We support the proposed rule change. We believe it's consistent with good appraisal practice. The issue . . . is how should an assessor do a decline in value assessment of an oil refinery? And the rule provides, as we understand it, that decline in value assessment of an oil refinery should be done on a fair market value basis, consistent with how a refinery typically is bought and sold in the marketplace.
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> Now, if a taxpayer comes before the assessor or the Assessment Appeals Board and can prove that -- that his refinery is actually being bought and sold in pieces, on a scrap basis, we would take that into consider[ation] in doing our decline in value assessment, or our . . . review.
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> But typically, you know, our experience is that oil refineries are bought and sold as operating enterprises, as economic units. This rule is consistent with the actual -- actual transactions in the marketplace and -- and these properties should be appraised consistent with the market, consistent with how other taxpayers are typically assessed in . . . these circumstances. And so we strongly support the rule.
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> Our office has worked with your staff to provide the economic data that's an input into the -- into the economic impact assessment. And frankly, that's a bit beyond our expertise. But on the substance, we strongly support the rule and we urge its adoption. (Transcript of Public Hearing, pp. 10-11.)

Comments from Contra Costa County

The Board received a letter dated December 16, 2014, from Mr. Donald Flessner, Executive Vice-President of Baker & O'Brien, Inc., in support of the Board's re-adoption of Rule 474. Mr. Flessner's letter provides as follows:

> I write in support of Property Tax Rule 474. My background includes more than 30 years of experience as a chemical engineer, as a commercial manager, and as a consultant in the petroleum refining industry. As reflected in my resume and accompanying experience list, which are attached to this letter, I spent over a decade working in refineries and learning various aspects of the refining business during my career in industry. Since that time, I have worked as a consulting expert in the petroleum refining, gas processing, and petrochemical industries. In this role, I have been involved in a variety of assignments involving the acquisition, privatization, and financing of petroleum refineries in the United States and abroad, and have served as an expert witness in

numerous litigation matters involving the refining and chemical process industries.

I am familiar with California property taxation and Rule 474 through my work for Contra Costa County. As a consultant for Contra Costa County, I have assisted the County in appraising the four refineries located there. I have also provided expert testimony to assist the County to defend against assessment appeals challenging the assessed value of taxable refinery property, among other services. I also have advised the County concerning the facts supporting the valuation of petroleum refineries, as provided by Rule 474.

The first fact that supports adoption of Rule 474 is that refineries are bought and sold as a single unit. During my career, I have reviewed the details of more than one hundred refinery sales and I only recall a handful of instances when a refinery's equipment has been sold separately from its land and improvements. Most, if not all of these sales, I would categorize as exigency sales that were not open market transactions or involved refineries that were no longer in operation. Due to this reality, there is little data to establish separate fair market values for refinery land, improvements and equipment.

The second significant fact supporting the necessity for Rule 474 is that buyers, sellers, and refinery operators are primarily interested in the income that is generated by the refinery. The income potential of a petroleum refinery is dictated by the installed processing equipment, which generally exceeds 80% of the total value of taxable property. However, because the fixtures at a refinery cannot contribute to income without the land on which they rest and, conversely, land at a refinery cannot produce income without the attached fixtures, income resulting from the refinery cannot be rationally allocated between these elements. In other words, the land, improvements and fixtures at refineries are physically and functionally integrated. For this reason, refinery operations planning, economic analysis, and management accounting do not allocate income to classes of assets, such as land, improvements, and equipment. Rather, income is measured and attributed to a refinery as a single economic unit.

As the income stream must be attributed to the refinery as a single unit, Rule 474 is necessary to value refineries under the income approach. In my experience, the income approach is used by buyers and sellers of refineries to establish the selling price in transactions. For purposes of determining assessed values, the income approach is often the preferred method for valuing refineries because sales comparisons are not always available and because many refineries in the United States have suffered significant depreciation or obsolescence that makes the cost approach

unreliable. Not only is it appropriate to value refineries as a single appraisal unit under the income approach, but the justification for requiring a separate appraisal unit for fixtures in order to account for fixture depreciation does not exist under the income approach. This is because the refinery income stream and the resulting value account for a lower level of performance that would result from physical depreciation of a refinery's fixtures by wear and tear or obsolescence. In addition, the income approach accounts for costs of maintenance and replacement that refineries incur to mitigate the effects of physical depreciation and obsolescence.

In conclusion, Rule 474 reflects the realities of the marketplace. Moreover, the rebuttable presumption provided by Rule 474 does not foreclose a refinery owner from presenting evidence that a refinery's fixtures are not part of the same economic unit as the refinery's land and improvements, while recognizing that such exceptions are few and far between. In recognizing how refineries are bought and sold, Rule 474 can help ensure that the market value of refineries is evaluated in accordance with the practice in the marketplace for purposes of decline-in-value valuations.

Mr. Flessner also appeared at the public hearing on December 18, 2014, provided testimony regarding his qualifications, and provided the following testimony in support of the Board's re-adoption of Rule 474:

As part of my work, I've advised Contra Costa County in the valuation of petroleum refineries located there. And . . . I have testified in four separate public hearings related to the assessed values of refineries in Contra Costa County as an industry expert.

In my work for the county, I have advised them that there are two facts that support the valuation of petroleum refineries as would be provided by Rule 474. The first fact is that refineries are bought and sold in the marketplace as single entire operations, as business enterprises, which include all of the land, fixtures, improvements, personal property that are required to operate the business. It's just the way things are done.

The second fact I've advised the county of is that buyers and sellers of refineries value these properties for their capacity to generate income. Beyond that, there is little concern for other things such as cost or other things like that.

The first fact is important because the true market value for operating refineries is established in the marketplace for the entire property. I've looked at more than a hundred refinery transactions that

have occurred since the early 80s, and there are very few examples where the refinery has not been sold as a single economic unit.

And when I look at those exceptions, what I find is that they're often exigency sales which were not either open market transactions or involved refineries that were no longer in operation and were being sold for salvage. For this reason, there is little market data to independently establish the fair market value for land, improvements and equipment that is used in petroleum refineries.

The second fact that I mentioned is important because income generated by a refinery is measured and attributed to the single economic unit. The income potential of a refinery is dictated by the installed processing equipment which generally exceeds more than 80 percent of the taxable property.

In operating a refinery, the most basic processing and investment decisions, such as what kind of crude oil to buy and how much gasoline or diesel fuel to produce, are evaluated based upon all of the equipment at the refinery, operating and working together in a planned [manner], in order to maximize income from the property.

For these reasons when I look at refinery economic planning, economic analysis and management accounting practices in the United States and around the world, there's just no activities that they undertake that measure or attribute income separately to land, improvements, fixtures or personal property.

[¶] . . . [¶]

I've reviewed the conclusions with respect to the economic impact analysis that was presented in the Board's statement. And from the basis of an industry background, I agree with the Board's conclusions.

Based on my experience in Contra Costa County, I agree that Rule 474 does not materially change the treatment of petroleum refineries under the RTC section 51(d). And based on my experience in the industry, I agree that Rule 474 will have no material impact on the petroleum refinery industry with respect to jobs, its competitive position with respect to other locations, or the ability of these businesses in the state of California to survive. (Transcript of Public Hearing, pp. 18-21.)

The Board received a letter dated December 16, 2014, from Mr. Gus Kramer, Contra Costa County Assessor, in support of the Board's re-adoption of Rule 474. Mr. Kramer's letter provides as follows:

I am the Assessor of Contra Costa County and have held this position for the past 20 years. During that time, I have become quite familiar with the valuation of refineries. I annually oversee the appraisal of four major petroleum refineries located in Contra Costa County and I have testified at hearings concerning their valuation.

I write in support of the readoption of Property Tax Rule 474. Rule 474 ensures fair and uniform taxation of petroleum refineries based on the concept of fair market value. As explained in the letter of Donald Flessner, a refinery, including land, buildings, tanks, machinery and equipment, is a collection of assets that functions together as a single unit to produce petroleum products. As also explained, such a property is valued and sold as a single integrated operating unit in any sale that is an open market nonexigency sale. Thus, an entire refinery generally is a single appraisal unit within the meaning of Revenue and Taxation Code section 51(d) and Rule 324(b). However, in those infrequent instances when land, improvements and fixtures [do] not transfer as an economic unit, Rule 474 permits assessors to separately value fixtures from land and improvements upon a proper showing.

Currently, several of the refineries in Contra Costa are valued under Proposition 8, as shown in the economic data that my office has provided to the Board to assist it in completing the economic impact assessment. Reenactment of Rule 474 is important to advance accurate assessment of the refineries. When petroleum refinery property is valued as a single appraisal unit, land, improvements and fixtures are jointly assessed under the lower of the collective fair market value or factored base year value for these assets. If these assets were not valued as a single unit, fixtures could be valued at their fair market value, while land and improvements are valued at their factored base year value, to create artificially low valuations that are inconsistent with the marketplace. Valuation of petroleum refinery property as a single appraisal unit also results in more accurate assessments because fixture depreciation can be offset by appreciation in land and improvements, reflecting the reality that refineries are generally bought and sold as a single unit.

For these reasons, and because the readoption of Rule 474 will assist assessors in clarifying the appraisal unit to be used when valuing petroleum refining properties for declines in value, I respectfully request that the Board reenact Rule 474.

The Board received a letter dated December 15, 2014, from Mr. David Twa, County Administrator for Contra Costa County, in support of the Board's re-adoption of Rule 474. Mr. Twa's letter provides as follows:

Contra Costa County respectfully requests that the Board of Equalization readopt Property Tax Rule 474, relating to the assessment of petroleum refineries. Four refineries are located in Contra Costa County. The County is charged with the valuation and taxation of the refineries, as well as the apportionment of the resulting property tax revenues to the County's public agencies. Rule 474 follows core principles of real property taxation in California and provides a necessary foundation for the proper taxation of refineries.

Rule 474 rebuttably presumes that a refinery constitutes a single appraisal unit based on evidence provided to the SBE that refineries are sold as a single unit in the marketplace. However, a refinery's fixtures may be valued separately if evidence is presented that (1) the fixtures "do not typically transfer in the marketplace" with the remainder of a refinery, or (2) that the fixtures are not functionally and physically integrated with the remainder of a refinery.

As the California Supreme Court recently confirmed, Rule 474 is in accord with constitutional and statutory authority. *(Western States Petroleum Association* v. *State Board of Equalization* (2013) 57 Cal. 4th 401 , 423 *[*"*Rule 474* is consistent with th[e] principle" that "appraisal of real property in the declining value context [should] reflect its 'full cash value' - that is, the value 'property would bring if exposed for sale in the open market.'"]). For valuation purposes, the proper appraisal unit is the collection of assets that persons in the marketplace normally buy and sell as a single unit. Revenue and Taxation Code section 51, which defines a taxable unit of real property, follows this tenet:

> For purposes of this section, ***"real property" means that appraisal unit that persons in the marketplace commonly buy and sell as a unit,*** or that is normally valued separately.

Rule 474 is consistent with property tax valuation principles set in the California Constitution, which require such valuations to be made on a fair market value basis. (Cal. Const., art. XIII, § 1 & art. XIII A, § 2; see also Rev. & Tax. Code, § 110(a) ["'full cash value' or 'fair market value' means the amount of cash or its equivalent that property would bring if exposed for sale in the open market . . . ."]).

If Rule 474 is not adopted, it might be claimed that land and improvements should be artificially separated in performing a refinery decline-in-value analysis under Rule 461(e). Such an approach would potentially result in a "tax windfall" for refinery owners because "account[ing] for fixture depreciation separately when land and fixtures are actually bought and sold as a single unit would allow the owner to

claim a reduction in real property value that is economically fictitious." *Western States Petroleum Association v. State Board of Equalization* (2013) 57 Cal. 4th 401, 423.

Rule 474 is also necessary to permit local assessors to carry out their duties without the risk of litigation or potential liability for taxpayer's attorney's fees under Revenue & Taxation Code section 538. Rule 46l(e) provides for the separate assessment of fixtures from land and improvements for decline-in-value appraisals. As explained above, interpreting Rule 461(e) to require fixtures to be a separate appraisal unit in every instance fails to conform to the constitutional and statutory requirement that an appraiser value a property as it would be valued by buyers and sellers in the marketplace. Yet, without Rule 474 in place, it might be claimed that assessors err in separately valuing fixtures from land and improvements. Rule 474 resolves any such confusion by clarifying that petroleum refineries should be valued first and foremost in accordance with the constitutional principle of full market value.

For these reasons, we respectfully request that the Board reenact Rule 474.

Ms. Rebecca Hooley, Deputy County Counsel for Contra Costa County, appeared at the public hearing on December 18, 2014, and provided the following testimony in support of the Board's re-adoption of Rule 474:

In Contra Costa County we have four refineries. And in valuing these refineries, we primarily rely on the income approach for performing decline [in] value valuations.

As mentioned by Mr. Flessner, income is generated by an integrated refinery unit comprised of land, improvements and fixtures. For this reason our valuation of refineries are, and have been, including the data submitted to the Board for the Board's economic impact analysis, consistent with Revenue and Taxation Code section 51(d) and the California Constitution as set forth in the Supreme Court's decision.

Although we are in compliance with Revenue and Taxation Code section 51(d), Rule 474 remains necessary. As shown by the letter submitted by WSPA, and which I first saw this morning, refinery owners continue to contend that refineries should be entitled to the lowest possible value by using a separate appraisal unit for land, fixtures and improvements. This creates an artificial value not seen in the marketplace, where in reality refineries are bought and sold as a single unit.

Contra Costa County has recently been through nine years of appeals and litigation relating to the value of a refinery. The refinery requested a refund of hundreds of millions of dollars from our county, and

> one of their main contentions was that their refineries should be valued as separate appraisal units.
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> With Rule 474 in place, much of this litigation could have been avoided and its re-enactment can help avoid such costly and unnecessary litigation in the future. For these reasons and the other reasons submitted by Contra Costa County, I ask the Board to re-enact Rule 474. (Transcript of Public Hearing, pp. 21-23.)

Mr. Peter Yu, Principal Appraiser of the Business Division for the Contra Costa County Assessor's Office, appeared at the public hearing on December 18, 2014, and provided the following testimony in support of the Board's assessment of the economic impact of re-adopting Rule 474:

> In my opinion, most of the taxable value of a refinery rests on its fixtures. And so the economic impact of treating a petroleum refinery as one appraisal unit versus separate appraisal units for fixtures and land and improvements is essentially the difference between the Proposition 13 and Proposition 8 values of the land and improvements appraisal unit because the fixtures valued under both scenarios would have been the main value component and assessed at the lower of Prop 13 versus Prop 8, in accordance to Revenue and Taxation Code section 51.
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> Since the total value of land improvements appraisal unit is, on average, less than 20 percent of the total refinery value under Prop 13 or Prop 8, the overall economic impact as researched by the Board staff will not be large and, therefore, conclusively indicates that there will be minimal economic impact caused by the re-adoption of Rule 474.
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> Finally, I believe any future fair market values of a refinery valued as a single appraisal unit . . . determined under accepted appraisal methods will be fully utilized and considered under Rule 474. (Transcript of Public Hearing, pp. 23-24.)

Response to Mr. Twa's and Ms. Hooley's Recommendations that the Board Re-Adopt Rule 474 to Reduce Potential Litigation and Discussion of Mr. Flessner's and Mr. Kramer's Comments Regarding the Application of the Rebuttable Presumption in Rule 474

In *WSPA v. BOE*, the California Supreme Court expressly considered whether or not to address the Western State Petroleum Association's (WSPA's) substantive grounds for challenging the validity of Rule 474 after the Court determined that the rule was procedurally invalid under the Administrative Procedure Act (ch. 3.5 of pt. 1 of div. 3 of tit. 2 (commencing with § 11340) of the Gov. Code) (APA). The Court said that:

> We note that "[o]rdinarily, when an appellate court concludes that affirmance of the judgment is proper on certain grounds it will rest its

> decision on those grounds and not consider alternative grounds which may be available. [Citations.] [¶] However, appellate courts depart from this general rule in cases where the determination is of great importance to the parties and may serve to avoid future litigation [citations], or where the issue presented is of continuing public interest and is likely to recur. [Citation.])" ([Citations.]) Here, although the rule's procedural deficiency is a sufficient basis for affirming the Court of Appeal's judgment, our consideration of the substantive ground for invalidating the rule is warranted. The issue presents a question of law, it has been thoroughly briefed, and it is a matter of considerable importance to the parties and to the public. (*WSPA v. BOE*, p. 409.)

In *WSPA v. BOE*, the California Supreme Court expressly held that Rule 474 was substantively valid based upon the following "straightforward reading of section 51(d)" (*WSPA v. BOE*, p. 417):

> [S]ection 51(d) states: "for purposes of this section, 'real property' means that appraisal unit that persons in the marketplace commonly buy and sell as a unit, or that is normally valued separately." By its terms, the statute provides two alternative methods of determining the appraisal unit that constitutes taxable real property: it is either (1) a unit "that persons in the marketplace commonly buy and sell as a unit" or (2) a unit "that is normally valued separately." Rule 474 applies the first method to petroleum refinery property. (*WSPA v. BOE*, p. 417.)

In *WSPA v. BOE*, the California Supreme Court also expressly stated that:

> For property whose fixtures are typically sold separately in the open market, fixtures are properly treated as a separate appraisal unit, and fixture depreciation may be independently recognized. But when land and fixtures are typically sold as a single unit, they are properly treated as a single appraisal unit, even if fixture depreciation is offset by land appreciation or otherwise reduced by valuing land and fixtures together. . . . To account for fixture depreciation separately when land and fixtures are actually bought and sold as a single unit would allow the owner to claim a reduction in real property value that is economically fictitious, resulting in a tax windfall. Neither California Constitution, article XIII A nor section 51 nor traditional appraisal practices require the unit of appraisal to be defined in a manner that maximizes the depreciation of fixtures in contravention of economic reality. To the contrary, the law and consistent practice have long required appraisal of real property in the declining value context to reflect its "full cash value"—that is, the value "property would bring if exposed for sale in the open market." (§§ 51(a)(2), 110.) Rule 474 is consistent with this principle. (*WSPA v. BOE*, p. 423.)

In addition, in Justice Kennard's concurring and dissenting opinion in *WSPA v. BOE*, Justice Kennard said that she agreed with the majority that Rule 474 was substantively valid because "Rule 474 correctly interprets [section 51(d)] . . . ." (*WSPA v. BOE*, p. 432.) Justice Kennard also expressly said that "it is section 51(d), not Rule 474, that provides the governing substantive standard. With or without Board rules elucidating the application of section 51(d) to specific types of property, section 51(d) adequately defines 'real property' and can be applied to various types of real property, including petroleum refinery properties, on a case-by-case basis. In other words, even without a rule on point, the Legislature's statutory definition of 'real property' is, by itself, a fully enforceable legal standard." (*WSPA v. BOE*, p. 435.)

As a result, the California Supreme Court decided to provide its own binding substantive interpretation of how section 51(d) applies to the valuation of petroleum refinery property for purposes of measuring declines in value because the Court specifically recognized that it is an important question of California law and the Court intended to avoid further litigation between WSPA, the Board, and county assessors regarding the issue. The Court expressly found that section 51(d) requires petroleum refinery property to be valued as a single appraisal unit for purposes of measuring declines in value when persons in the marketplace actually buy and sell refinery property as a unit because the appraisal of refinery property in the declining value context must reflect the value the "property would bring if exposed for sale in the open market." The Court also expressly found that it is important for county assessors to apply its interpretation of section 51(d) to petroleum refinery property, under such circumstances, in order to prevent an unintended "tax windfall."

Therefore, based upon a straightforward reading of *WSPA v. BOE*, the California Supreme Court intended for its interpretation of RTC section 51(d) to establish a binding precedent. The Court intended for that binding precedent to take effect immediately to prevent the unintended "tax windfall" and avoid future litigation. And, the Court gave no indication that it intended for county assessors to delay their implementation of the Court's interpretation of section 51(d) and allow the unintended tax windfall to continue for any reason, including bringing a declaratory relief action against the Board, under RTC section 538,[1] to establish that Rule 461(e) does not apply to the valuation of petroleum refinery property for decline in value purposes when persons in the marketplace actually buy and sell refinery property as a unit.

[1] RTC section 538, subdivision (a), provides that "If the assessor believes that a specific provision of the Constitution of the State of California, of this division, or of a rule or regulation of the board is unconstitutional or invalid, and as a result thereof concludes that property should be assessed in a manner contrary to such provision, or the assessor proposes to adopt general interpretation of a specific provision of the Constitution of the State of California, or this division, or of a rule or regulation of the board, that would result in a denial to five or more assessees in that county of an exemption, in whole or in part, of their property from property taxation, the assessor shall, in lieu of making such an assessment, bring an action for declaratory relief against the board under Section 1060 of the Code of Civil Procedure. The court shall allow intervention in such action by potential assessees and other assessors under Section 387 of the Code of Civil."

Furthermore, the California Supreme Court has previously held that a Board regulation that conflicts with the California Supreme Court's interpretation of a statute exceeds the Board's rulemaking authority and is invalid. (See, e.g., *Preston v. State Board of Equalization* (2001) 25 Cal. 4th 197, 219 [holding that provisions in Regulation 1540 are invalid because they conflict with the Court's interpretations of sections 6011 and 6012].) And, the California Supreme Court has expressly held that when a petroleum refinery's "land and fixtures are typically sold as a single unit, they are properly treated as a single appraisal unit, even if fixture depreciation is offset by land appreciation or otherwise reduced by valuing land and fixtures together." (*WSPA v. BOE*, p. 423.) Therefore, the courts would likely hold that the application of Rule 461(e) to petroleum refinery property is invalid when persons in the marketplace actually buy and sell refinery property as a unit because, under such circumstances, Rule 461(e)'s application to petroleum refinery property would restrict county assessors' statutory authority under section 51(d), as interpreted by the California Supreme Court in *WSPA v. BOE*, and result in what the California Supreme Court called an "economically fictitious" unintended "tax windfall." (*WSPA v. BOE*, p. 423.) And, as such, Rule 461(e), by itself, cannot provide a legal basis for prohibiting a county assessor from currently finding, in accordance with section 51(d), as interpreted by the California Supreme Court in *WSPA v. BOE*, that petroleum refining property constitutes a single appraisal unit for measuring declines in value when substantial evidence indicates that petroleum refining property is currently bought and sold as a single unit in the marketplace.

Moreover, the provisions of RTC section 538 are enforced through the application of RTC section 5152, which provides as follows:

> In an action in which the recovery of taxes is allowed by the court, if the court finds that the void assessment or void portion of the assessment was made in violation of a specific provision of the Constitution of the State of California, of this division, or of a rule or regulation of the board, and the assessor should have followed the procedures set forth in Section 538 in lieu of making the assessment, the plaintiff shall be entitled to reasonable attorney's fees as costs in addition to the other allowable costs. This section is ancillary only, and shall not be construed to create a new cause of action nor to be in lieu of any other provision of law.

In *Prudential Insurance Company of America v. City and County of San Francisco* (1987) 191 Cal.App.3d 1142, 1159 (hereafter *Prudential*), the California Court of Appeal interpreted RTC section 5152 as only "entitling litigants to attorney fees upon a showing either of an erroneous assessment on taxable property or an assessment on nontaxable property," not just a mere showing that an assessor did not follow a statute or regulation without first bringing a declaratory relief action against the Board under RTC section 538. And, in *Phillips Petroleum Company v. County of Lake* (1993) 15 Cal. App. 4th 180, 197, the Court of Appeal reviewed its interpretation of RTC section 5152 in *Prudential* and stated that its *Prudential* "opinion makes it clear that to justify an award of attorney fees it is essential that the flawed assessment result from the assessor's erroneous belief that a particular provision, rule or regulation is unconstitutional or invalid."

Here, the California Supreme Court has expressly held that when a petroleum refinery's "land and fixtures are typically sold as a single unit, they are properly treated as a single appraisal unit, even if fixture depreciation is offset by land appreciation or otherwise reduced by valuing land and fixtures together." (*WSPA v. BOE*, p. 423.) Therefore, there would be no basis to award attorney's fees to a litigant whose petroleum refinery was properly valued as one appraisal unit, pursuant to the California Supreme Court's interpretation of RTC section 51(d) in *WSPA v. BOE*. In addition, there is no basis to conclude that the county assessors are required to bring a declaratory relief action against the Board, under RTC section 538, to establish that Rule 461(e) does not apply to the valuation of petroleum refinery property for decline in value purposes when persons in the marketplace actually buy and sell refinery property as a unit. This is because the Board has already agreed that Rule 461(e) does not apply to the valuation of petroleum refinery property for decline in value purposes when persons in the marketplace actually buy and sell refinery property as a unit, as evidenced by the Board's initial adoption of Rule 474, the Board's defense of Rule 474 in its prior litigation with WSPA, and the Board's initiation of the rulemaking process to re-adopt Rule 474 after it was invalidated on procedural grounds.

However, Ms. Reheis-Boyd's letter and Mr. Craig A. Becker's testimony (discussed below) indicate that WSPA continues to believe that Rule 461(e) generally applies to petroleum refinery property, even though WSPA does not seem to be continuing to dispute the fact that petroleum refineries are commonly bought and sold as a unit in the marketplace. And, Ms. Reheis-Boyd's letter and Mr. Becker's testimony indicate that WSPA will not agree that petroleum refinery land, improvements, and fixtures may constitute a single appraisal unit for determining declines in value, under RTC section 51(d), until the Board re-adopts Rule 474 in compliance with the APA's requirements. Therefore, the Board agrees with Mr. Twa's comment that it is necessary for the Board to re-adopt Rule 474 "to permit local assessors to carry out their duties without the risk of litigation or potential liability for taxpayer's attorney's fees under [RTC] section 538." The Board also agrees with Ms. Hooley's comment that the Board's re-adoption of Rule 474 "can help avoid . . . costly and unnecessary litigation in the future."

Finally, the Board agrees with Mr. Flessner's comment that "the rebuttable presumption provided by Rule 474 does not foreclose a refinery owner from presenting evidence that a refinery's fixtures are not part of the same economic unit as the refinery's land and improvements." The Board also agrees with Mr. Kramer's comment that "in those infrequent instances when land, improvements and fixtures [do] not transfer as an economic unit, Rule 474 permits assessors to separately value fixtures from land and improvements upon a proper showing." Therefore, the Board's re-adoption of Rule 474's *rebuttable* presumption that petroleum refinery property constitutes a single appraisal unit for measuring declines in value is also necessary to avoid unnecessary future litigation regarding the proper appraisal unit when there is evidence to establish that a petroleum refinery's fixtures are required to be valued as a separate appraisal unit under RTC section 51(d).

Public Comments Opposing the Re-Adoption of Rule 474 and the Board's Responses to the Public Comments Opposing the Re-Adoption of Rule 474

Email from Ms. Schumacher

The Board received an email on October 24, 2014, from Ms. Michelle Schumacher. Ms. Schumacher's email quotes the text of subdivision (d)(2) of Rule 474 and states that:

> I am very concerned with the preferential treatment that refineries are being given - this is NOT acceptable - make the taxation fair - tired of this and tired of having special interests and special rules that allows for the oil industry to not have to own up as the rest of us do regarding taxes.
>
> In addition due to the toxic nature of their business they should actually be paying more.

Response to Ms. Schumacher's Email

RTC section 51(d) provides that "'real property' means that appraisal unit that persons in the marketplace commonly buy and sell as a unit, or that is normally valued separately." The Board has determined, based upon all of the information in the rulemaking file, that petroleum refineries are commonly bought and sold as a unit in the marketplace. Therefore, as explained in the initial statement of reasons, county assessors are currently authorized by RTC section 51(d), as interpreted by the California Supreme Court in *WSPA v. BOE*, to determine that petroleum refinery property (land, improvements, and fixtures) constitutes a single appraisal unit for measuring declines in value, unless there is evidence to establish that some or all of a refinery's fixtures should be valued as a separate appraisal unit because those fixtures are not commonly bought and sold as a unit with the refinery's land and improvements.

As explained in the initial statement of reasons, the Board has determined, based upon all the information in the rulemaking file, that it is reasonably necessary to re-adopt Rule 474 to:

- Clarify that petroleum refinery land, improvements, and fixtures are rebuttably presumed to constitute a single appraisal, under RTC section 51(d), because petroleum refineries are commonly bought and sold as a unit in the marketplace; and
- Petroleum refinery fixtures do not constitute a separate appraisal unit, as provided in Rule 461(e), unless there is evidence to establish that some or all of a refinery's fixtures should be valued as a separate appraisal unit because those fixtures are not commonly bought and sold as a unit with the refinery's land and improvements.

The Board has determined that Rule 474 is fully consistent with the existing mandates of RTC section 51(d), and that there is nothing in the proposed re-adoption of Rule 474 that

would significantly change how individuals and businesses, including county assessors and petroleum refinery owners, would generally behave due to the current provisions of RTC section 51(d), as interpreted by the California Supreme Court in *WSPA v. BOE*. And, the Board anticipates that the re-adoption of Rule 474 will clarify the treatment of petroleum refinery property for purposes of measuring declines in value, and thereby benefit county assessors and the owners of petroleum refineries by promoting fairness and uniformity in the assessment of petroleum refinery property throughout the state.

Also, as explained in the initial statement of reasons and above, the California Supreme Court has concluded that "Rule 474's market-based approach to determining the proper appraisal unit for petroleum refinery property ensures that reductions in property values are measured according to fair market value." (*WSPA v. BOE*, pp. 416-417.) The Court also said that "[t]o account for fixture depreciation separately when land and fixtures are actually bought and sold as a single unit would allow the owner to claim a reduction in real property value that is economically fictitious, resulting in a tax windfall. Neither California Constitution, article XIII A nor section 51 nor traditional appraisal practices require the unit of appraisal to be defined in a manner that maximizes the depreciation of fixtures in contravention of economic reality. To the contrary, the law and consistent practice have long required appraisal of real property in the declining value context to reflect its 'full cash value'—that is, the value 'property would bring if exposed for sale in the open market.' (§§ 51(a)(2), 110.)" (*WSPA v. BOE*, p. 423.) Therefore, the Board has determined that Rule 474 is fair because it is fully consistent with the existing mandates of RTC section 51(d), as interpreted by the California Supreme Court in *WSPA v. BOE,* and the Board does not agree that Rule 474 provides preferential treatment to petroleum refinery property.

Letter from Ms. Gina Rodriquez

The Board received a letter dated December 17, 2014, from Ms. Gina Rodriquez, Vice President of State Tax Policy for the California Taxpayers Association (CalTax), which requested that the Board reject the re-adoption of Rule 474 and alleged that the Board failed to comply with the APA in assessing the economic impact of the re-adoption of Rule 474. Ms. Rodriquez letter provides as follows:

> In considering the re-adoption of Rule 474, CalTax is interested in preserving the integrity of the Administrative Procedures Act (APA), Government Code §§11346.2(b)(5)(A), 11346.3 and 11346.5(a)(8), as well as the California Supreme Court's directive in *Western States Petroleum Assn. v. Board of Equalization* (2013) 57 Cal.4th 401 (2013), which determined that the original Rule 474 was invalid due to its lack of an economic impact analysis.
>
> CalTax has significant concerns about re-adoption of Rule 474, including the Board's failure to follow the APA rules and to comply with Government Code §§11346.2(b)(5)(A), 11346.3 and 11346.5(a)(8). Until the Board has substantially complied with these statutory and regulatory

requirements, the Board must reject Rule 474's re-adoption, and the rule must continue to be found invalid.

Pursuant to Government Code §11346.3(a), the Board must address as part of its economic impact analysis the potential for adverse economic impact. This requires the agency to base the regulation on adequate information regarding the need for, and consequences of, the proposed rule; and to "consider the proposal's impact on business, with consideration of industries affected including the ability of California businesses to compete with businesses in other states."

The Board's proposed economic impact analysis fails to assess: whether and to what extent the proposed rule will affect the creation or elimination of jobs within the state; the creation of new businesses or the elimination of existing businesses within the state; the expansion of businesses currently doing business within the state; and the benefits of the regulation to the health and welfare of California residents, worker safety, and the state's environment.

The Supreme Court set a clear mandate on the Board for its regulations to satisfy the APA. However, the Board's proposed economic impact analysis fails to make a reasoned estimate of all the cost impacts of the rule on affected parties. The Board's economic impact analysis does not consider the full economic impact of the rule, and, therefore, does not comply with the Supreme Court's mandate. For these reasons, the Board should reject proposed Rule 474.

Responses to Letter from Ms. Gina Rodriquez

Board staff responded to the comments in Ms. Rodriquez's December 17, 2014, letter during the public hearing on December 18, 2014. Staff explained that:

In [*WSPA v. BOE*], the California Supreme Court concluded that [Rule 474] was substantively valid because petroleum refineries are commonly bought and sold as a unit and the presumption in the rule is consistent with Revenue and Taxation Code section 51(d) which defines real property as the appraisal unit that persons in the marketplace commonly buy and sell as a unit.

However, the court invalidated the rule on procedural grounds because the court concluded that the Board did not properly assess the economic impact . . . of the rule under the [APA]. This was because the Board based its entire assessment on a revenue estimate and the court found that the Board could not explain why the . . . methodology used in the revenue estimate was a valid or reasonable way to estimate the amount of fixture depreciation that would be offset by appraising land and fixtures as a single appraisal unit.

Therefore, staff has performed a new evaluation of the economic impact of re-adopting Rule 474. Staff has determined that currently assessors may treat petroleum refining property as one appraisal unit under section 51(d) as interpreted by the California Supreme Court; Rule 474 does not materially change the treatment of petroleum refinery property under section 51(d); and that there is no economic impact from the re-adoption of Rule 474 that is in addition to the economic impact of section 51(d).

In addition, staff has clearly explained the methodology used to assess the economic impact of the re-adoption of Rule 474 in the initial statement of reasons[2] and staff believes that the . . . methodology is reasonable. (Transcript of Public Hearing, pp. 5-6.)

[¶] . . . [¶]

[T]he Board received a written comment from Gina Rodriquez, Vice President of Tax Policy for the California Taxpayers Association, which requested that the Board reject the rule because the Board failed to follow the APA and comply with Government Code sections 11346.2 subdivision (b)(5)(A), 11346.3 and 11346.5 subdivision (a)(8).

Therefore, staff reviewed all of the rulemaking documents and confirmed that the economic impact assessment complies with Government Code section . . . 11346.2 subdivision (b)(5)(A) because it clearly identifies the facts, evidence, documents, testimony and other evidence supporting the initial determination that the re-adoption of Rule 474 will not have a significant adverse economic impact on business.

The economic impact assessment complies with the applicable provisions of Government Code section 11346.3 subdivision (b) because pages 14 and 15 of the initial statement of reasons expressly provide that due to the current application of section 51(d), the re-adoption of Rule 474 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand businesses in the State of California; and that the re-adoption of . . . Rule 474 will not affect the benefits of the rule to the health and welfare of California residents, worker safety, or the state's environment because Rule 474 does not regulate the health and welfare of California residents, worker safety, or the state's environment.

And the economic impact assessment complies with Government Code section 11346.5 subdivision (a)(8) because page 8 of the Board's notice contains the declaration that the Board has made an initial

[2] See pages 13 and 14 of the initial statement of reasons.

> determination that the re-adoption of proposed Rule 474 will not have a significant statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states.
>
> And the initial statement of reasons provides the facts, evidence, documents, testimony, or other evidence upon which the Board relies to support its initial determination.[3] (Transcript of Public Hearing, pp. 7-8.)

Ms. Reheis-Boyd's Letter & Mr. Becker's Testimony on Behalf of WSPA

Letter from Ms. Reheis-Boyd

The Board received a letter dated December 17, 2014, from Ms. Reheis-Boyd, President of WSPA, which provided WSPA's comments regarding the Board's re-adoption of Rule 474. The first page of the letter states that "WSPA opposes Rule 474 because the Board failed to comply with the requirements under the Administrative Procedures Act ('APA'), Gov. Code §§ 11346.2(b)(5)(A), 11346.3 and 11346.5(a)(8)." It states that, in *WSPA v. BOE*, the California Supreme Court held that the Board's initial adoption of Rule 474 was procedurally invalid because "the Board failed to assess the economic impact of Rule 474 and thus the Board's initial determination that the rule would not have a significant adverse economic impact on business did not substantially comply with the APA. Specifically, the Court held that the Board's assessment was inadequate because it failed to make a reasoned estimate of all the cost impacts of the rule on the affected parties." It also provides WSPA's opinion that "the Board failed to rectify these deficiencies in its newest version of the proposed rule."

The second page of Ms. Reheis-Boyd's letter summarizes provisions of article XIII A of the California Constitution, RTC section 51, and Rule 461, and then explains that: "As an exception to the basic rule in Rule 461(e) that fixtures must be treated as a separate appraisal unit from land and improvements, the Board adopted Rule 474 in 2007. Rule 474 established a separate, specific rule for the assessment of petroleum refining properties. Rule 474(d)(2) provided that for petroleum refining properties, land, improvements and fixtures are rebuttably presumed to be one appraisal unit. Accordingly, declines in value in fixtures due to depreciation would not be allowed to the extent that they were offset by increases in the fair market value of land and improvements." The third and fourth pages of Ms. Reheis-Boyd's letter summarize provisions of the APA, specifically Government Code sections 11346.2, 11346.3, subdivisions (a) and (b), 11346.5, subdivisions (a) and (c), and 11350, subdivision (b)(2).

The fourth and fifth pages of Ms. Reheis-Boyd's letter contain the following summary of the California Supreme Court's holding in *WSPA v. BOE* that the Board's assessment of the economic impact of the Board's initial adoption of Rule 474 was inadequate:

[3] See page 10 of the initial statement of reasons.

Despite the leeway and deference given to agencies, the Supreme Court found the Board's initial determination that Rule 474 would not have a significant adverse impact on business failed to substantially comply with the APA requirement that the Board *actually assess* the potential adverse economic impact on businesses based on the facts. An agency must *actually assess* the potential adverse economic impact on California businesses and individual businesses, which calls "for an evaluation based on facts." *(Western States Petroleum,* 57 Cal. 4th at 428, citing *California Assn. of Medical Products Suppliers v. Maxwell-Jolly,* 199 Cal. App. 4th 286 *(Maxwell-Jolly).)*

The Supreme Court upheld the trial court's finding that the Board had not adequately estimated the increased taxes that would result from treating refineries as a single appraisal unit for decline in value purposes. *(Western States Petroleum,* 57 Cal. 4th at 430.) As noted above, the principal effect of Rule 474 and its combining of land and improvements with fixtures as a single appraisal unit is to allow the erosion of fixture fair market value beneath fixture adjusted base year value to be assessed to the extent land and building values had appreciated above their adjusted base year values. The potential land appreciation that would now be subject to property tax is limited to the extent fixture value has fallen below its adjusted base year value. The trial court held that the economic impact statement required an accurate measure of these potential assessment increases and that "as a theoretical matter, surely there should be some quantification of the effect of depreciation of fixtures on assessed value." *(Ibid.)* Since the Board had not provided an accurate estimate of refinery fixture depreciation (indeed it provided no estimate at all), the Supreme Court summarily affirmed the trial court, rejecting the Board's analysis because it:

> [F]ailed to provide "an economic impact based on data concerning fixture depreciation on assessed values" and thus "leaves a reader without an understanding of what the taxes on a representative refinery would have been under the formerly applicable Rule 461(e), and what the taxes would be under the new rule 474(d)(2)." *(Ibid*., quoting the Court of Appeal.)

The Supreme Court agreed with the trial court and Court of Appeal because the Board did not explain how its analysis was a "valid or reasonable way to estimate the amount of fixture depreciation that would be offset by appraising land and fixtures as a single unit." (*Ibid*.) The Supreme Court stated further, "[E]ven if the Board's prediction of future land appreciation were correct, the Board's calculation failed to consider

> prior land appreciation and the full tax impact that would occur if land were valued at actual market value rather than adjusted base year value."[4]
>
> The Supreme Court clearly enunciated the standard the Board must satisfy: The Board's estimate must consider prior land appreciation and quantify the amount of fixture depreciation that would be offset by the land appreciation if land were assessed at its actual market value (under Rule 474) instead of its adjusted base year value (under Rule 461(e)). Then, the estimate must calculate the full property tax impact that would occur under each scenario. By failing to meet these standards, the Supreme Court concluded that the Board failed to make a reasoned estimate of all cost impacts of the rule on affected parties.
>
> In light of the Supreme Court's *Western States Petroleum* decision, Rule 474 was invalidated. However, shortly thereafter the Board initiated the rulemaking process to re-adopt Rule 474.

The fifth page of Ms. Reheis-Boyd's letter provides WSPA's opinion that the Board's assessment of the economic impact of the re-adoption of Rule 474 "ignored all prior law, including fully ignoring Rule 461(e)." The fifth and sixth pages of Ms. Reheis-Boyd's letter provide the following quotes from three sentences, selected from three paragraphs in the Board's assessment of the economic impact of the re-adoption of Rule 474 on pages 13 and 14 of the initial statement of reasons:

> Board staff determined that, in the absence of Rule 474, county assessors are currently authorized by RTC section 51(d), as interpreted by the California Supreme Court in *WSPA v. BOE,* to determine that petroleum refinery property (land, improvements, and fixtures) constitutes a single appraisal unit for measuring declines in value when persons in the marketplace commonly buy and sell refinery property as a unit.
>
> [...]
>
> Therefore, Board staff concluded that the re-adoption of Rule 474 is fully consistent with the existing mandates of RTC section 51(d), and that there is nothing in the proposed re-adoption of Rule 474 that would significantly change how individuals and businesses, including county assessors and petroleum refinery owners, would generally behave due to the current provisions of R TC section 51(d) as interpreted by the California Supreme Court in *WSPA v. BOE.*
>
> As a result, the Board has determined that the re-adoption of Rule 474 does not impose any costs on any persons, including businesses, in

[4] The California Supreme Court's complete discussion of the Board's assessment of the economic impact of its initial adoption of Rule 474 is on pages 429 to 431 of *WSPA v. BOE,* and the Board included relevant quotes from the Court's discussion on pages 7 and 8 of the initial statement of reasons.

> addition to whatever costs are imposed by RTC section 51 (d) as interpreted by the California Supreme Court in *WSPA v. BOE,* and there is nothing in Rule 474 that would impact revenue.

Then, the sixth page of Ms. Reheis-Boyd's letter states that "[t]his fails to comply with the APA and the clear mandate from the Supreme Court that the Board make an initial *actual assessment* of the economic impact of Rule 474." The sixth page of Ms. Reheis-Boyd's letter states that "the Board does not believe" that "assessors are already authorized to assess the land, improvements and fixtures of petroleum refining properties as a single appraisal unit for decline in value purposes under RTC § 51(d)" and, even if the Board did, then "[i]n effect, the Board is arguing that Rule 474 is unnecessary because the rule it establishes is already provided for by statute under RTC § 51(d)." The sixth page of Ms. Reheis-Boyd's letter also states that "[u]nder this argument, no property tax regulation would ever impose a cost because it could always be deemed to be consistent with its underlying authorizing statute" and states that the Board agreed that Rule 474 represented a substantive change in the Board's interpretation of section 51(d) at the time it was first adopted by the Board.

The sixth and seventh pages of Ms. Reheis-Boyd's letter provide as follows:

> . . . Just because the Supreme Court held that the prior Rule 474 was *substantively* valid as an appropriate interpretation of RTC § 51(d) and consistent with Proposition 13 does not mean that Rule 474 was not a change in the prior regulatory interpretation of Rule 461(e). Accordingly the Supreme Court was correct in demanding that the Board quantify the additional tax revenue that would be collected as result of Rule 474 [as] well as the additional costs imposed as compared to a world without Rule 474.
>
> To that point, it is clear from the Supreme Court that the requisite comparison for economic impact is to compare the costs to businesses without the regulation to the costs to businesses with the regulation. Without Rule 474, Rule 461(e) states, without equivocation, that for purposes of calculating declines in value, "fixtures and other machinery and equipment classified as improvements constitute a separate appraisal unit." There is no other specific rule applicable to petroleum refining property. The Supreme Court clearly endorsed the trial court's view that the Board is required to calculate the increased taxes, taking into consideration the effect of fixture depreciation on assessed values. *(Western States Petroleum,* 57 Cal. 4th at 430.) In addition, the Supreme Court agreed with the Court of Appeal's holding that the Board must calculate the difference in taxes on refineries using Rule 461(e) and the new proposed Rule 474, stating that the Board's analysis in the first adoption of Rule 474 "'leaves a reader without an understanding of what the taxes on a representative refinery would have been under the formerly applicable Rule 461(e), and what the taxes would be under the new rule

> Rule 474(d)(2).'" (*Ibid*.) Thus, the Board' s comparison of the effect of its proposed Rule 474 to the costs on business under RTC § 51(d) is not the correct comparison, and thus the statement that the rule imposes no costs fails to satisfy the APA requirement that the agency *actually assess* the potential adverse economic impacts of a proposed regulation.

The seventh page of Ms. Reheis-Boyd's letter acknowledges that the Board "sought data regarding market values and adjusted base year values of refineries from the county assessors through the California Assessors' Association, for tax years 2009 through 2013" so that the Board could "accurately compare the total assessed value of [each] petroleum refinery when its fixtures are valued as a separate appraisal unit under Rule 461(e) and valued as part of the same appraisal unit with land and improvements under Rule 474," as explained in the initial statement of reasons. It also acknowledges that the Board was able to obtain "the information [for] 10 refineries" and that the Board included both the "data and its analysis of the data" for the ten refineries in Attachment F to the initial statement of reasons. However, the seventh page of Ms. Reheis-Boyd's letter also states that the Board's analysis "failed to comport with the [California] Supreme Court's mandate." In addition, the eighth page of the letter provides that this is because "the Supreme Court mandate requires[that] the Board's estimates must use data that is accurate." WSPA's opinion is that the data the Board obtained from the county assessors "substantially overstated" the fair market value of the refineries' fixtures. And, as a result, WSPA's opinion is that the Board's analysis of the data "greatly understate[s] the depreciation in fixture value underneath their respective base year values," does not accurately determine how much "depreciation would be offset by land appreciation," and "would leave 'a reader with without an understanding of what the taxes on a representative refinery would have been under' Rule 461(e) compared to what they would be under the proposed Rule 474."

The eighth page of Ms. Reheis-Boyd's letter states that WSPA was "able to match the Board's 10 Refineries A through J [from Attachment F to the initial statement of reasons] to their owners" and found that "the 10 refineries that the Board used for its analysis and set forth in Attachment F are all within Los Angeles and Contra Costa County." The eighth page of the letter provides WSPA's opinion that "the best standard measure for refinery value is fair market value per 'complexity barrel.' The value of a refinery is proportional to its complexity times its crude capacity, or complexity-barrels." The eighth page of the letter states that "[t]he complexity barrels of refining capacity figure for each refinery is public information" (without identifying the source of the information), and states that "Exhibit 1 [to the letter] shows the range of Board values per complexity barrel of the 10 refineries analyzed," without identifying nine of the ten refineries or the complexity factors WSPA used to make its calculations. In addition, Exhibit 1 to the letter provides one unchanging "Complexity Barrels of Refinery Capacity" number for each of the 10 refineries. Exhibit 1 provides "Low" and "High" "Board Determined Fair Market Values of Fixtures" for each of the ten refineries from "2009 to 2013," which correspond to the lowest and highest "market values" for fixtures for each refinery, in the county assessor-provided data set forth in Attachment F to the

initial statement of reasons.[5] And, Exhibit 1 provides "Low" and "High" "Board Determined Fair Market Values Per Complexity Barrel of Refinery Capacity" for each of the ten refineries from "2009 to 2013," which WSPA calculated by dividing each refinery's low and high fixture values by each refinery's listed "Complexity Barrels of Refinery Capacity" number. As a result, Exhibit 1 provides the following "Low" and "High" "Board Determined Fair Market Values Per Complexity Barrel of Refinery Capacity" for Refineries A through J from 2009 to 2013:

	Low	High
Refinery A	$446	$619
Refinery B	$463	$665
Refinery C	$697	$919
Refinery D	$541	$588
Refinery E	$475	$1,136
Refinery F	$344	$1,489
Refinery G	$431	$810
Refinery H	$315	$413
Refinery I	$384	$490
Refinery J	$281	$719

Then, the eighth and ninth pages of Ms. Reheis-Boyd's letter state that the low and high Board Determined Fair Market Values Per Complexity Barrel of Refinery Capacity "range from $281 for Refinery J in one year, up to $1,489 for Refinery F in another year. As repeated here below, these values are all over the place, and ought to be within a consistent, tight range, especially because the 10 refineries that the Board used for its analysis and set forth in *Attachment F* are all within Los Angeles and Contra Costa County. [Table of "Board Determined Fair Market Values Per Complexity Barrel of Refinery Capacity" from Exhibit 1 omitted.] Because there are such wild variances in the values per complexity barrel in the Board's data and analysis, it is clear that the Board's estimates of fair market value of the fixtures at the refineries in *Attachment F* to the *Initial Statement* are badly flawed. There is no reasonable reason why these figures would be so wildly different."

The ninth page of Ms. Reheis-Boyd's letter identifies Refinery A in Attachment F to the Board's initial statement of reasons as the "Carson" refinery, which was included in the "June 2013 sale of BP's Carson, California refinery and related logistics and marketing assets in the region to Tesoro Corporation for approximately $2.4 billion," discussed in the Board's initial statement of reasons and BP's June 2013 press release, which was included as Attachment E to the initial statement of reasons. The ninth page of the letter concludes, based upon Tesoro Corporation's "Annual Statement on Form 10-K filed with the U.S. Securities and Exchange Commission for the fiscal year ending December 31, 2013" (hereafter Form 10-K), that Tesoro purchased the Carson refinery and other "non-

[5] For example, the low and high fixture values for Refinery A in Exhibit 1 are the 2013 fixture market value of $1,359,876,090 and the 2010 fixture market value of $1,887,388,187 for Refinery A in Attachment F, respectively.

refinery" assets in the June 2013 transaction, and Tesoro Corporation subsequently "sold the non-refinery assets to a related entity." The ninth page of the letter also concludes, apparently based on BP's June 2013 press release, that "[t]he amount Tesoro Corporation paid for all of the assets, including the non-refinery assets, was $1.075 billion *total for the entire bundle*." The ninth page of the letter also states that "[c]learly the non-refinery assets have value, which means that the value of the refinery assets alon[e] is less than the $1.075 billion Tesoro paid for *all of the assets*." And, the tenth page of Ms. Reheis-Boyd's letter states that the "Board estimated a fair market value of the Refinery A *fixtures alone* in 2013 at $1.360 billion (and the entire refinery including land, plus all the non-refinery assets, sold for $1.075 billion)."

The ninth and tenth pages of Ms. Reheis-Boyd's letter provide that, even assuming "for the sake of argument only" that the Carson refinery's value was $1.075 billion, "and allocating 89 percent to the fixtures and 11 percent to the land . . ., that means that the value of Refinery A [fixtures] on a complexity barrel basis was $313 [footnote omitted] in 2013," using the Complexity Barrels of Refinery Capacity number for Refinery A from Exhibit 1. Then, the tenth page states that the "$313 value per complexity barrel is significantly below the Board's refinery A low-to-high range of $446-619 per complexity barrel shown on Exhibit 1." It also states that "It is clear that the $313 is only higher than two values, the value for refinery J from 2010, and Refinery H from 2013.[6] Of course, once the non-refinery values are removed from the Tesoro Acquisition $1.075 billion total purchase price, clearly the Carson refinery market value per complexity barrel would be lower than all of the Board's estimates, *for all 10 refineries, in all five years*. Some of the Board estimates are two to four times the $313 figure before removing the non-refinery assets. This demonstrates how unrealistic and unreasonable the Board's estimates are. The best evidence of the fair market value of a California refinery is the Carson refinery, as established through the June 2013 sale, and *all* of the Board's estimates exceed that value by significant margins."

Exhibit 2 to Ms. Reheis-Boyd's letter provides one unchanging "Crude Barrels of Refinery Capacity" number for each of the 10 refineries listed in Attachment F to the initial statement of reasons, without identifying nine of the ten refineries or providing the source(s) for the numbers. For example, without explanation, Exhibit 2 uses "252,000" crude barrels of refinery capacity for Refinery A, which WSPA has identified as the Carson refinery, but does not use the 240,000 barrel per day capacity for the Carson refinery referred to in the history of California's petroleum refineries from the Energy Almanac, included as Attachment B to the initial statement of reasons, and does not use the 266,000 barrel per day capacity for the Carson refinery referred to in BP's June 2013 press release, included as Attachment E to the initial statement of reasons. Exhibit 2 provides the same "Low" and "High" "Board Determined Fair Market Values of Fixtures" for each of the ten refineries from "2009 to 2013," which are provided in Exhibit 1 to the letter. Exhibit 2 also provides "Low" and "High" "Board Determined Fair Market Values of Fixtures Per Crude Barrel of Refinery Capacity" for each of the

[6] Exhibit 1 to Ms. Reheis-Boyd's letter provides "Low" and "High" "Board Determined Fair Market Values Per Complexity Barrel of Refinery Capacity" of "$315" and "$413" for Refinery H. So, it does not appear that "$313" is higher than the values for Refinery H.

ten refineries from "2009 to 2013," which WSPA calculated by dividing each refinery's low and high fixture values by each refinery's listed Crude Barrels of Refinery Capacity number.

WSPA's "low" and "high" "Board Determined Fair Market Values of Fixtures Per Crude Barrel of Refinery Capacity" numbers from Exhibit 2 are also set forth on the tenth and eleventh pages of Ms. Reheis-Boyd's letter. However, it should be noted that the high and low numbers provided in the letter are not consistent with the high and low numbers provided in Exhibit 2 for Refinery A and the low number provided in Exhibit 2 for Refinery J, and that the high and low numbers provided in Exhibit 2 are the correct quotients. The eleventh page of Ms. Reheis-Boyd's letter also states that "[u]sing the Carson refinery as a good example again to demonstrate how overstated the Board's estimates are, even if the entire $1.075 [billion] purchase price figure were used to determine fair market value per barrel of refining capacity, the figure would be $3,800 [footnote omitted]. Compare this (which again includes all of the non-refinery assets) to the Board's estimates of per barrel of capacity fair market values of fixtures for the 10 refineries on Exhibit 2." In addition, the eleventh page of the letter states that "the Board's estimates of all of the other nine refineries [besides Refinery A] are all inconsistent with the arm's length, market-based value of California refineries on a per barrel of capacity basis."

The eleventh page of Ms. Reheis-Boyd's letter further provides that, "[e]ven if we simply look at the overall fair market values the Board ascribed to all of the refineries for lien date 2013 (land, improvements and fixtures combined), and compare them to the Carson refinery, it is clear that the Board's figures are wildly overstated." The eleventh page of the letter provides a list entitled "Board's Overall Fair Market Value Estimates for Lien Date 2013 from Attachment F." And, the list provides the following total combined 2013 current market values for fixtures, land, and improvements for Refineries A through I, and the total combined 2012 current market values for fixtures, land, and improvements for Refinery J, from the county assessor-provided data set forth in Attachment F to the Board's initial statement of reasons:

Refinery A	$1,533,355,051 (the Carson refinery)
Refinery B	$1,766,347,425
Refinery C	$1,362,773,677
Refinery D	$1,292,007,019
Refinery E	$1,821,953,554
Refinery F	$1,368,262,574
Refinery G	$1,318,591,387
Refinery H	$624,523,309
Refinery I	$924,198,374
Refinery J	$ 3,722,232,049 (2012)

The eleventh and twelfth pages of the letter also state that:

> The Carson refinery sold in June 2013 along with a bundle of non-refinery assets for a total purchase price of $1.075 billion. That total purchase price for *all of the assets* is lower than eight of the 10 Board-derived total refinery fair market values for 2013 (and 2012 for Refinery J, since 2013 data was not provided). Given that the Carson refinery is one of the largest refineries in California in terms of refinery capacity in complexity barrels and in overall crude barrel refining capacity, it makes absolutely no sense that all of the other Board determined fair market values would exceed the arm's-length sales price value of the Carson refinery. And certainly when the non-refinery assets are removed from the $1.075 billion purchase price, it is clear that *all* of the Board's fair market value estimates exceed the actual Carson refinery fair market value as of the sale date.
>
> The point is that the Tesoro Acquisition provides a supportable fair market value measure of a quality, well-equipped refinery that is well-located in a metropolitan area with significant demand for its product. Given these enormous variances in value, it is difficult for the Board to argue that its estimates are reasonable. In fact, the Board's failure to adequately estimate the true magnitude of fixture depreciation is exactly the error the Supreme Court concluded was the fatal flaw in the Board economic analysis in the first version of Rule 474. (See *Western States Petroleum*, 57 Cal. 4th at 430.)

The twelfth page of Ms. Reheis-Boyd's letter refers to the Board's use of "past data to estimate the future impact of Rule 474" as a "misjudgment." The twelfth and thirteenth pages of Ms. Reheis-Boyd's letter discuss a simple example, provided as an attachment to the letter, to illustrate the effect of different data on the Board's calculations. In the example, WSPA assumes that a hypothetical refinery has fixtures with an adjusted base year value of $200 million and a fair market value of $50 million, and land with a base year value of $25 million and a fair market value of $175, so that all of the hypothetical $150 million of depreciation in the fixtures can be offset by the hypothetical $150 million of appreciation in the land if the hypothetical refinery's property is valued as one appraisal unit. WSPA assumes that the Board has incorrectly determined that the fair market value of the hypothetical refinery's fixtures is $150 million and, as a result, the Board has incorrectly determined that only $50 million of fixture depreciation can be offset by the $150 million of land appreciation if the hypothetical refinery's property is valued as one appraisal unit, and that the offsetting has a "property tax cost" of "approximately $500,000 (one percent of $50 million)." And, WSPA assumes that the Board should have correctly concluded that all of the $150 million of fixture depreciation can be offset by the $150 million of land appreciation if the hypothetical refinery's property is valued as one appraisal unit, and that the offsetting would have a "property tax cost" of "approximately $1,500,000 (one percent of $150 million)." On the thirteenth page of the letter, WSPA concludes that "the incremental assessed value produced by Rule 474 using an accurate measure of the fixture value is $150 million instead of $50 million in this example. The incremental property tax collected from the refinery would

be $1.5 million, three times the incremental tax effect produced by the Board's overstated fixture value."

The thirteenth page of Ms. Reheis-Boyd's letter states that: "As further evidence that the Board's estimates of fixture fair market value are greatly overstated are the multiple cases where the Board's purported fixture fair market values on a particular refinery exceed that refinery's fixture Proposition 13 adjusted base year value (the fixture cost when newly added adjusted annually by the Proposition 13 inflation factor). (See *Initial Statement. Attachment F:* Page 1-Refinery E for 2009 and 2012; Page 2-Refinery F for 2009 and 2012, Refinery G for 2009, Refinery I for 2009 and 2010, and Refinery J for 2012.) This is obviously incorrect. As any appraiser would confirm, industrial fixtures lose significant value as soon as they start production. Thus, it is nearly impossible for industrial fixtures to ever have a fair market value in excess of their adjusted base year value. Yet, the Board's flawed analysis contains multiple examples of the implausible conclusion that refinery fixtures actually *appreciate in value*."

The thirteenth page of Ms. Reheis-Boyd's letter also states that: "Here, in the present proposal, the Board's initial economic impact assessment uses data from *only 10 of the 20 major refineries*, and thus it continues to draw its conclusion from only half of the available data. WSPA believes that the Supreme Court would continue to question the validity of the Board's conclusions as to the statewide impact of Rule 474 since the Board's analysis continues to be based on data from only half of the California refineries."

Finally, the fourteenth page of Ms. Reheis-Boyd's letter states that:

> WSPA believes that the Board failed to [properly] comply with the APA provision set out in Gov. Code§ 11346.3(b)(l), which requires the Board' s economic impact assessment to assess whether and to what extent Rule 474 would affect (i) the creation or elimination of jobs in California; (ii) the creation of new businesses or the elimination of existing businesses within California; (iii) the expansion of businesses currently doing business in California; and (iv) the benefits of the rule to the health and welfare of California residents, worker safety, and the California environment. WSPA believes that to comply with this requirement, it is not enough for the Board to say, perfunctorily, that Rule 474 would not have an impact on any of these matters.

Mr. Becker's Testimony

Mr. Becker, an attorney for Pillsbury Winthrop Shaw Pittman, LLP, appeared at the public hearing on December 18, 2014, and provided the following testimony opposing the Board's re-adoption of Rule 474 on behalf of WSPA:

> Well, first of all, let's be straight about what's going on here. This is a real change. Prior to 474 -- or I should say prior to the proposed Rule

474, industrial manufacturing operations had land and fixtures assessed separately under 461(e); that was the law.

The Supreme Court recognizes that in their decision when they say "any attempt to change the law under Rule 474 is quasi legislative and a change." They go on to say that the Board has the power to make that change. We regrettably disagree with that conclusion by the Supreme Court, but nevertheless, the Supreme Court said it.

The fact is the Supreme Court starts this analysis by saying that the current law is 461(e). Absent 474, we value fixtures separately from land and buildings. And we do that not just for refineries, we do that for all industrial operations, all manufacturing operations.

474 singles out refineries for a special rule. It singles them out for a special rule. Now regrettably, the Supreme Court said we can do that.

So basically what we're here for today is we're going to argue that the economic impact statement is inaccurate. It's inaccurate and unacceptable and will destine Rule 474 to being failing -- to fail again before the Supreme Court.

Now why is that the case? I guess to help the Board understand my argument, I'd ask you to turn to the last page of the WSPA submission where we talk about what's really going on here. And what's really going on here is Rule 474 allows fixture depreciation to be subject to property tax.

So when fixtures depreciate beneath the base year value -- as in refineries they almost certainly will because it's an industrial operation where fixtures are used up in the process of making oil and gas products -- that decline in value currently, under 461(e), cannot be taxed. You have to go to the fair market value.

474 says I can grab that decline in value and tax it to the extent of land depreciation. Okay. We got to measure that. We got to measure that accurately to tell the economic impact of what's going on here.

Now, [Board staff] made an attempt at that, but it's not a very accurate one. When you look at what they've done and how they've come up with those numbers, those numbers are far in excess -- the fair market value numbers they came up with are far in excess of market values. And because they're in excess of market values, in measuring the spread, the extra spread between base year value and market value that can be captured, they've minimized the tax impact. Because the fair market

value of refinery fixtures is actually much, much lower, the tax impact is much broader of allowing that depreciation to be taxed.

The principal evidence we present for this -- you didn't even have to look far for it -- it was in the Board's economic impact statement that they presented. It's the recent sale, in June of 2013, of the . . . the BP Carson refinery . . . to Tesoro. That refinery sold for a billion dollars. It's not $2.4 billion as is noted in some of the Board's materials, but for a billion dollars, a billion 75 million. The remaining amount was for inventories which are not taxed.

But beyond that, that billion 75 included much, much more than the refinery. It included marine terminals. It included service stations. It included trade names.

Actually, when you think about this transaction, those items, those other items are the vast majority of this transaction. So really, the refinery value is a minor fraction of that billion dollars.

Nevertheless, let's look at that billion dollars because we have that as an objective number to look at. When you look at that billion dollars in relation to crude capacity of this refinery, it produces a value of $3800 per barrel of crude capacity.

Now, I ask you to go to Exhibit 2 of what WSPA presented. These are the numbers that the Board presents as their estimates of fair market value. They go from a low of, I think, $5400 per barrel of crude capacity for the Carson refinery to $20,000 per barrel of crude capacity. This is what they're saying the fair market values are of these fixtures in the face of a recent transaction, for a number at $3800 which is vastly below this. And that $3800 is vastly overstated because it includes tons of other assets.

That $3800 we expect could go well beneath a thousand dollars. So we're talking about a spread here in fair market value that the Board presented from numbers as high as $20,000 per crude capacity down to a thousand dollars.

And because of that spread, because of that spread and that high number that's on this analysis, we believe they have greatly understated the amount of extra assessment that these refineries will be subject to.

The spread again that these refineries will be subject to is the base -- the base year value against the fair market value. And if you overstate that fair market value, that tax effect of that spread is going to be minimized. And their analysis is based on that minimal spread.

> That's what we're unhappy about. We're, of course, unhappy about Rule 474 because the refineries don't like being singled out differently from other industrial operations; that's not fair. But despite that, we're even -- we're equally unhappy about the fact that the economic impact statement has understated, greatly understated the true cost of this measure. And therefore, the analysis that says there's no jobs effect, there's no economic effect, there's no effect on California industry, all of that extra money is going to be taken away from refinery production activities and . . . not able to go into the free enterprise system.
>
> So there is an economic effect that's much greater than what the Board's analysis is saying. And, therefore, we respectfully submit that the economic impact statement is flawed and cannot be accepted. (Transcript of Public Hearing, pp. 11-16.)

When asked whether or not WSPA thought additional dialogue and discussion would actually be helpful in reaching a conclusion that WSPA would be satisfied with, Mr. Becker added that:

> I guess a couple of things that I think we got to get a perspective on here. Since Prop 13 was adopted in 1978, industrial manufacturing facilities of all kinds have had fixtures treated separately from land and buildings. Okay. 461(e) is the law now. Absent adoption of 474, it remains the law.
>
> Okay. We can talk about what kind of regulation you can or cannot adopt. I don't disagree that the Supreme Court regrettably said you could adopt this regulation. Okay. But, one, it's not the law now. You can't do this now. Okay.
>
> So this is a change. It is a major change for which refineries are being singled out. We find that problematic.
>
> Okay. Number two, we think the economic impact statement that is sitting with you right now is badly flawed. (Transcript of Public Hearing, pp. 31 and 32.)

When asked if WSPA would provide any input to help correct the perceived errors in the Board's assessment of the economic impact of the re-adoption of Rule 474, Mr. Becker responded that:

> I would relate to you a conversation I had with one of our members in advance of this hearing where we talked about this topic. And he said, it seems to me that Rule 474 is taking tax money from me. And . . . if the Board is asking me if I'm going to open the door and help them take tax money from me, I don't know that I'm very excited about that.

> . . . I mean, I don't know how to answer that. I'd have to pay – we'd have to solicit our members to talk about that. But we - - see this as wrong. We see the economic impact statement that there's wrong. We gave information today why it's wrong. We will continue to believe it's wrong. It's a - - it's a massive change, isolating refineries. We think it's wrong, and we think the economic impact statement's wrong. (Transcript of Public Hearing, pp. 32 and 33.)

During the public hearing, Board staff said that Mr. Becker's testimony indicated that WSPA still thinks the law currently requires petroleum refinery fixtures to be appraised separately for purposes of measuring declines in value, that WSPA still wants to litigate the substance of what RTC section 51(d) says, and staff does not believe that further discussion would lead to agreement between staff and WSPA that county assessors can currently value petroleum refinery fixtures as part of the same appraisal unit with its land and improvements under RTC section 51(d). (Transcript of Public Hearing, pp. 37 and 38.) Board staff also said that when WSPA has attacked the specific numbers in the Board's economic impact assessment, both in Ms. Reheis-Boyd's letter and in Mr. Becker's testimony, their comments are kind of misdirecting the Board because they are attacking the county assessors' values, the Board would have to value all of the refineries as of all the different lien dates to determine whether the county assessors' values were correct, and the APA does not require the Board to independently value all of California's petroleum refineries. (Transcript of Public Hearing, p. 38.) Mr. Becker responded to Board staff's comments by saying:

> First of all, the Supreme Court's very clear that Rule 474 is a change. Okay. Let's -- let's – let's let that stand. So this is a change.
>
> Secondly, we're using a market transaction, the last one that's available actually, to show why all of their fair market value numbers are overstated and, therefore, that they understate the tax effect.
>
> That -- that market transaction was something that was included in [staff's] materials. [Staff] didn't do any analysis of it. The analysis of it that we did and submitted today shows that their numbers have problems. (Transcript of Public Hearing, pp. 40-41.)

When asked if there were any examples of negative economic impact from the re-adoption of Rule 474, Mr. Becker responded that:

> Well, let -- let me answer your question this way: The Supreme Court was very clear that what the Board of Equalization did not do the first time around was accurately measure the depreciation and fixtures, accurately measure the spread between base year value and fair market value.

> And that number actually -- you know, obviously requires a solid number of fair market value for the fixtures. And our presentation was directed exactly [at] what the Supreme Court said it need[ed] to be done; which is, you need an accurate number for the fair market value of the fixtures. (Transcript of Public Hearing, p. 44.)

Finally, when asked what other values Board staff should have used besides the county assessors' values, Mr. Becker responded that the Board should use the numbers from the "Tesoro transaction" and the "billion 75 million" sales price of "BP's assets" as a unit. (Transcript of Public Hearing, p. 46.) And, Mr. Becker explained further that:

> It -- my argument in using this data point, Chairman Horton, is toward the economic impact statement. That the economic impact statement, per the Supreme Court's directive, needs to accurately measure the spread between base year value and fair market value. Because that's ultimately the potential that can be taxed. And that's extra tax an industry will bear.
>
> That has to be accurately done. And that's not been accurately done because this data point -- the only market data point in all this analysis is monumentally below even the lowest data point. The spread is far wider than they're saying. (Transcript of Public Hearing, p. 47.)

Responses to Ms. Reheis-Boyd's Letter & Mr. Becker's Testimony on Behalf of WSPA

Responses to Comments Regarding the Effect of the Re-Adoption of Rule 474

As explained by the California Supreme Court in its *WSPA v. BOE* opinion, Rule 324, *Decision*, currently defines the term "appraisal unit" to mean "'a collection of assets that functions together, and that persons in the marketplace commonly buy and sell as a single unit or that is normally valued in the marketplace separately from other property . . . .'" (*WSPA v.* BOE, p. 411 [quoting Rule 324, subd. (b)].) As explained in *WSPA v. BOE*, the Board adopted the provisions of Rule 461(e), "[i]n the wake of Proposition 13 and Proposition 8" and before RTC section 51 was enacted (and then subsequently amended to include its current definition of "real property")[7] to establish a broad rule "applicable to most real property used for manufacturing" that:

> Declines in value will be determined by comparing the current lien date full value of the appraisal unit to the indexed base year full value of the same unit for the current lien date. Land and improvements constitute an appraisal unit except when measuring declines in value caused by disaster, in which case land shall constitute a separate unit. For purposes of this

[7] Rule 461's reference note refers to "Article XIII A, Sections 1 and 2, California Constitution," but does not refer to RTC section 51.

> subdivision,[8] fixtures and other machinery and equipment classified as improvements constitute a separate appraisal unit. (*WSPA v.* BOE, p. 411.)

This is because persons in the marketplace commonly did and still commonly do buy and sell most land and improvements as a single unit, but persons in the marketplace did not commonly and still do not commonly buy and sell most fixtures as part of the same unit with land and improvements.

Also, as explained in *WSPA v. BOE*, "[i]n September 2006, the Board voted three to two to adopt Rule 474[9] to address 'the valuation of the real property, personal property, and fixtures used for the refining of petroleum.'" (WSPA v. BOE, p. 411.) Rule 474, subdivision (d)(2), provided that "*The land, improvements, and fixtures and other machinery and equipment classified as improvements for a petroleum refining property are rebuttably presumed to constitute a single appraisal unit*." (WSPA v. BOE, p. 412.) "Before [initially] adopting Rule 474[:]

> [T]he Board held a hearing at which several public officials testified in favor of the rule. Typical was the testimony of Rick Auerbach, the Los Angeles County Assessor, who stated that in his experience "refineries in California . . . are bought and sold as a unit. . . . I am not aware of one that has not been sold as a unit. If we have a case where there is the potential for a refinery to be dismantled and sold–where the fixtures are sold separately, the proposed rule is a rebuttable presumption and we would take that into account. And we would value the fixtures separately."
>
> The Board concluded in its final statement of reasons before adopting the rule that "sufficient evidence in the rulemaking record exists to determine that proposed Rule 474 is necessary to obtain assessments more accurately reflecting how petroleum refinery properties would actually trade in the marketplace. . . . At the June 27, 2006 Property Tax Committee meeting, Thomas Parker, Deputy County Counsel, Sacramento County; Rick Auerbach, Los Angeles County Assessor and President of the California Assessor's Association; Lance Howser, Chief Assessor, Solano County; and Robert Quon, Director of Major Appraisals for the Los Angeles County Assessor's office, all testified that refineries are in fact bought, sold, and valued as a single unit. In the same meeting, Mr. Auerbach testified that refineries are different from other heavily-fixtured manufacturing industries such as breweries, canneries, and amusement parks and toy manufacturing. Refineries are unique in that up to 80 percent of their values are contained in the fixtures and because the land and fixtures are so integrated, it is difficult to physically separate the

[8] The Board amended Rule 461(e) to replace "subsection" with "subdivision," but has not made any substantive amendments to Rule 461(e) since its adoption.

[9] Prior to its repeal in 2013, Rule 474's reference note referred to "Article XIII Section 1, and Article XIII A, Section 2, California Constitution; Sections 51 and 110.1, Revenue and Taxation Code."

> fixtures from the land. Further, the land and fixtures are also so economically integrated that a buyer normally would not, in a fair market transaction, purchase the land separately from the fixtures or the fixtures separately from the land. [¶] Since petroleum refineries are bought and sold as a unit consisting of land and fixtures, to value the fixtures separate and apart from the land may result in assessed values either below or above fair market value in violation of Propositions 8 and 13." (*WSPA v. BOE*, p. 413.)

And, "[p]etroleum refinery property was covered by Rule 461(e) until the Board's [initial] adoption of Rule 474." (*WSPA v. BOE*, p. 411.) Therefore, the Board agrees with the California Supreme Court that the Board's initial adoption of Rule 474, in 2006, was intended to change the way the Board's rules apply when measuring declines in value of petroleum refinery property. The Board also agrees with the California Supreme Court that the change was based upon evidence that refineries are commonly bought and sold as a unit in the marketplace, and the Board's determination that Rule 474 is necessary to obtain assessments more accurately reflecting how petroleum refinery properties would actually trade in the marketplace. And, the Board agrees that after its initial adoption in 2006, Rule 474 was a new rule with general application to petroleum refineries, which both interpreted RTC section 51(d) and limited the application of Rule 461(e).

In August 2013, the California Supreme Court held that Rule 474 was procedurally invalid under the APA so that it no longer had the force and effect of law. Therefore, the Board subsequently repealed Rule 474 pursuant to Rule 100, effective October 30, 2013, in order to clarify its rules, and Rule 474 has no effect on how county assessors measure declines in value of petroleum refinery property today.

In August 2013, the California Supreme Court also addressed the substantive validity of repealed Rule 474, which necessarily required an analysis of the proper appraisal unit to be used to measure declines in value of petroleum refinery property, based upon current California property tax law, including RTC section 51(d) and Rule 324, as applied to the general marketplace for petroleum refineries. The Court addressed the substantive validity of repealed Rule 474 because the Court found that it presented "a question of law, it ha[d] been thoroughly briefed, and it is a matter of considerable importance to the parties and to the public." (*WSPA v. BOE*, p. 409.) And, the Court expressly held that Rule 474 was substantively valid based upon the following "straightforward reading of section 51(d)" (*WSPA v. BOE*, p. 417):

> [S]ection 51(d) states: "for purposes of this section, 'real property' means that appraisal unit that persons in the marketplace commonly buy and sell as a unit, or that is normally valued separately." By its terms, the statute provides two alternative methods of determining the appraisal unit that constitutes taxable real property: it is either (1) a unit "that persons in the marketplace commonly buy and sell as a unit" or (2) a unit "that is

> normally valued separately." Rule 474 applies the first method to petroleum refinery property." (*WSPA v. BOE*, p. 417.)

The California Supreme Court also expressly stated that:

> For property whose fixtures are typically sold separately in the open market, fixtures are properly treated as a separate appraisal unit, and fixture depreciation may be independently recognized. But when land and fixtures are typically sold as a single unit, they are properly treated as a single appraisal unit, even if fixture depreciation is offset by land appreciation or otherwise reduced by valuing land and fixtures together. . . . To account for fixture depreciation separately when land and fixtures are actually bought and sold as a single unit would allow the owner to claim a reduction in real property value that is economically fictitious, resulting in a tax windfall. Neither California Constitution, article XIII A nor section 51 nor traditional appraisal practices require the unit of appraisal to be defined in a manner that maximizes the depreciation of fixtures in contravention of economic reality. To the contrary, the law and consistent practice have long required appraisal of real property in the declining value context to reflect its "full cash value"—that is, the value "property would bring if exposed for sale in the open market." (§§ 51(a)(2), 110.) (*WSPA v. BOE*, p. 423.)

In addition, in Justice Kennard's concurring and dissenting opinion in *WSPA v. BOE*, Justice Kennard said that she agreed with the majority that Rule 474 was substantively valid because "Rule 474 correctly interprets [section 51(d)] . . . ." (*WSPA v. BOE*, p. 432.) Justice Kennard also expressly said that "it is section 51(d), not Rule 474, that provides the governing substantive standard. With or without Board rules elucidating the application of section 51(d) to specific types of property, section 51(d) adequately defines 'real property' and can be applied to various types of real property, including petroleum refinery properties, on a case-by-case basis. In other words, even without a rule on point, the Legislature's statutory definition of 'real property' is, by itself, a fully enforceable legal standard." (*WSPA v. BOE*, p. 435.)

As a result, in August 2013, the California Supreme Court provided its own substantive interpretation of how California property tax law applies to the valuation of petroleum refinery property for purposes of measuring declines in value in order to avoid further litigation between WSPA, county assessors, and the Board regarding the issue. The Court held that, under the Court's interpretation of California property tax law, particularly RTC section 51(d), it is necessary to value petroleum refinery property as a single appraisal unit for purposes of measuring declines in value when persons in the marketplace actually buy and sell petroleum refinery property as a unit because the appraisal of petroleum refinery property in the decline in value context must reflect the value the property would bring if exposed for sale in the open market. The Court also found that it is important for county assessors to apply its interpretation of section 51(d) to petroleum refinery property, under such circumstances, in order to prevent an

unintended "tax windfall." Therefore, the Court intended for its interpretation of RTC section 51(d), as applied to the current marketplace for petroleum refineries, to establish a binding precedent to take effect immediately to prevent an unintended "tax windfall." The Court gave no indication, express or otherwise, that it intended to prohibit county assessors from assessing petroleum refinery property in a manner that is consistent with the Court's interpretation of section 51(d), until such time as the Board re-adopted Rule 474.

In addition, valuing petroleum refinery property as one "appraisal unit" is consistent with Rule 324 (quoted above) when substantial evidence indicates that petroleum refinery property is currently bought and sold as a single unit in the marketplace. Also, as explained above, the California Supreme Court has held that a Board regulation that conflicts with the Court's interpretation of a statute exceeds the Board's rulemaking authority and is invalid. So, Rule 461(e) cannot provide a legal basis for prohibiting a county assessor from finding, based upon current California property tax law, including RTC section 51(d) and Rule 324, as interpreted by the California Supreme Court in *WSPA v. BOE*, that petroleum refining property constitutes a single appraisal unit for measuring declines in value when substantial evidence indicates that petroleum refinery property is currently bought and sold as a single unit in the marketplace.

The initial statement of reasons explains that the Board confirmed that persons in the marketplace still commonly buy and sell operable California petroleum refineries as a unit prior to proposing to re-adopt Rule 474. (Initial Statement of Reasons, pp. 11-13.) It explains that Board staff determined how the re-adoption of Rule 474 might change (or effect) the current assessment of petroleum refining property and thereby have an economic impact on county assessors and the California petroleum refining industry in accordance with the APA. (Initial Statement of Reasons, p. 13.) It also explains that:

> Board staff determined that, in the absence of Rule 474, county assessors are currently authorized by RTC section 51(d), as interpreted by the California Supreme Court in *WSPA v. BOE*, to determine that petroleum refinery property (land, improvements, and fixtures) constitutes a single appraisal unit for measuring declines in value when persons in the marketplace commonly buy and sell refinery property as a unit. Therefore, Board staff determined that, as a result, county assessors are currently required to monitor the market for petroleum refinery property. However, in the absence of substantial changes in the California petroleum refinery market (discussed above), it is also currently reasonable for a county assessor to generally value petroleum refinery property as a single appraisal unit, for purposes of measuring declines in value, and rely on each petroleum refinery owner to produce evidence, when available, to establish that some or all of its refinery's fixtures should be valued as a separate appraisal unit because those fixtures are not commonly bought and sold as a unit with the refinery's land and improvements.

Board staff determined that the re-adoption of Rule 474 does not materially change the treatment of petroleum refinery property under RTC section 51(d) as interpreted by the California Supreme Court in *WSPA v. BOE*. Instead, the re-adoption of Rule 474 has the effect of clarifying that, based upon the California petroleum refinery market (discussed above):

- "The land, improvements, and fixtures and other machinery and equipment classified as improvements for a petroleum refining property are rebuttably presumed to constitute a single appraisal unit" for purposes of determining declines in value because doing so is generally consistent with RTC section 51(d) as interpreted by the California Supreme Court in *WSPA v. BOE*; and
- Rule 461(e)'s provisions providing that "fixtures and other machinery and equipment classified as improvements constitute a separate appraisal unit" for purposes of determining declines in value do not apply to petroleum refinery property, unless there is evidence that treating specific fixtures as a separate appraisal unit would be consistent with RTC section 51(d) as interpreted by the California Supreme Court in *WSPA v. BOE*.

In addition, Board staff determined that, after the re-adoption of Rule 474, a county assessor would still need to continue to monitor the market for petroleum refinery property because Rule 474 does not supersede RTC section 51(d) and because the presumption in Rule 474 is rebuttable. Staff determined that, after the re-adoption of Rule 474 and in the absence of substantial changes in the California petroleum refinery market, county assessors could continue to generally value petroleum refinery property (land, improvements, and fixtures) as a single appraisal unit. Board staff also determined that, after the re-adoption of Rule 474 and in the absence of substantial changes in the California petroleum refinery market, county assessors could continue to rely on each petroleum refinery owner to produce evidence to establish that some or all of its refinery's "fixtures" should be valued as a separate appraisal unit because those fixtures are not commonly bought and sold as a unit with the refinery's land and improvements, when available. Therefore, Board staff concluded that the re-adoption of Rule 474 is fully consistent with the existing mandates of RTC section 51(d), and that there is nothing in the proposed re-adoption of Rule 474 that would significantly change how individuals and businesses, including county assessors and petroleum refinery owners, would generally behave due to the current provisions of RTC section 51(d) as interpreted by the California Supreme Court in *WSPA v. BOE*. (Initial Statement of Reasons, pp. 13-14.)

Therefore, the Board has correctly and properly concluded that county assessors are required to follow the California Supreme Court's binding precedential opinion regarding the proper appraisal unit to be used to measure declines in value of petroleum refinery

property, based upon current California property tax law, including RTC section 51(d) and Rule 324, as applied to the general marketplace for petroleum refineries, which the Court provided after the Board's initially adopted Rule 474. The Board has correctly concluded that Rule 474 is fully consistent with the California Supreme Court's binding precedential opinion. And, the Board has correctly concluded that, due to the California Supreme Court's binding precedential opinion, the Board's re-adoption of Rule 474 does not substantially change the valuation of petroleum refinery property for purposes of measuring declines in value, as did the Board's initial adoption of Rule 474. Instead, the Board's current re-adoption of Rule 474 has the effect of clarifying that, based upon the California petroleum refinery market (discussed above):

- "The land, improvements, and fixtures and other machinery and equipment classified as improvements for a petroleum refining property are rebuttably presumed to constitute a single appraisal unit" for purposes of determining declines in value because doing so is generally consistent with RTC section 51(d) as interpreted by the California Supreme Court in *WSPA v. BOE*; and
- Rule 461(e)'s provisions providing that "fixtures and other machinery and equipment classified as improvements constitute a separate appraisal unit" for purposes of determining declines in value do not apply to petroleum refinery property, unless there is evidence that treating specific fixtures as a separate appraisal unit would be consistent with RTC section 51(d) as interpreted by the California Supreme Court in *WSPA v. BOE*.

And, the Board disagrees with Ms. Reheis-Boyd's letter and Mr. Becker's testimony to the extent they:

- Assert that Rule 461(e) still generally applies to the valuation of petroleum refinery property when persons in the marketplace commonly buy and sell petroleum refinery property as a unit;
- Assert that the California Supreme Court's binding precedential opinion regarding the proper appraisal unit to be used to measure declines in value of petroleum refinery property, based upon current California property tax law, including RTC section 51(d) and Rule 324, as applied to the general marketplace for petroleum refineries, does not currently apply to the valuation of petroleum refinery property; and
- Conclude that the re-adoption of Rule 474 substantially changes the valuation of petroleum refinery property for purposes of measuring declines in value, as did the Board's initial adoption of Rule 474.

Further, as provided on page 8 of the initial statement of reasons, the Board received a letter dated August 20, 2013, from Ms. Moller, in which she explained that "the California Supreme Court's opinion in *WSPA v. BOE*, which upheld the substantive validity of Rule 474, but still invalidated the rule on procedural grounds, created an issue

(or problem within the meaning of Gov. Code, § 11346.2, subd. (b)(1)) for county assessors in counties with petroleum refinery property as to:

- Whether petroleum refinery land, improvements, and fixtures constitute a single appraisal unit for determining declines in value, under RTC section 51 and the substantive policy expressed in Rule 474, because petroleum refineries are commonly bought and sold as a unit in the marketplace; or
- Whether petroleum refinery fixtures constitute a separate appraisal unit, as provided in Rule 461, subdivision (e) . . . ."

"In the letter, Ms. Moller also requested that the Board initiate the rulemaking process to re-adopt Rule 474 to clarify that petroleum refinery land, improvements, and fixtures are rebuttably presumed to constitute a single appraisal unit for determining declines in value." (Initial Statement of Reasons, p. 9.) In addition, the Board received a written statement from Robert Cooney, Appraiser Specialist with the Los Angeles County Assessor's Office, which requested that the Board re-adopt Rule 474 to "codify a practice already employed by the County of Los Angeles." (Initial Statement of Reasons, p. 9.) Therefore, even though the adoption of Rule 474 does not substantially change the valuation of petroleum refinery property for purposes of measuring declines in value, the Board correctly determined in the initial statement of reasons that "it is reasonably necessary to re-adopt Rule 474 for the specific purpose of addressing the issue (or problem) identified in Ms. Moller's August 20, 2013, letter by clarifying that petroleum refinery land, improvements, and fixtures are rebuttably presumed to constitute a single appraisal unit for determining declines in value because petroleum refineries are commonly bought and sold as a unit in the marketplace." (Initial Statement of Reasons, p. 10.) Also, Mr. Twa's and Ms. Hooley's recommendations that the Board re-adopt Rule 474 to *reduce potential litigation* (discussed above) provide further support for the Board's determination that it is reasonably necessary to clarify the Board's rules regarding the proper appraisal unit for measuring declines in value of petroleum refinery property.

Furthermore, the Board has not based its assessment of the economic impact of the re-adoption of Rule 474 on the assertion that property tax rules that are consistent with existing statutes can "never" impose costs. Instead, the Board has reasonably concluded that its re-adoption of Rule 474 does not substantially change the valuation of petroleum refinery property for purposes of measuring declines in value, as did the Board's initial adoption of Rule 474, based upon all the current facts and circumstances. This is because Rule 474 simply provides that petroleum refinery property is rebuttably presumed to be a single appraisal unit. This is because, since the Board's initial adoption of Rule 474, the California Supreme Court has:

- Held that, under the Court's interpretation of California property tax law, particularly RTC section 51(d), it is necessary to value petroleum refinery property as a single appraisal unit for purposes of measuring declines in value when persons in the marketplace actually buy and sell petroleum refinery property as a unit because the appraisal of refinery property in the decline in value context

must reflect the value the property would bring if exposed for sale in the open market;

- The Court has said that it is important for county assessors to apply its interpretation of RTC section 51(d) to petroleum refinery property, under such circumstances, in order to prevent an unintended tax windfall; and
- The Court has held that Rule 474 is consistent with RTC section 51(d).

This is also because, in the initial statement of reasons, the Board determined that, "in the absence of Rule 474, county assessors are currently authorized by RTC section 51(d), as interpreted by the California Supreme Court in *WSPA v. BOE*, to determine that petroleum refinery property (land, improvements, and fixtures) constitutes a single appraisal unit for measuring declines in value when persons in the marketplace commonly buy and sell refinery property as a unit." (Initial Statement of Reasons, p. 13.) The Board also determined that "the re-adoption of Rule 474 does not materially change the treatment of petroleum refinery property under RTC section 51(d) as interpreted by the California Supreme Court in *WSPA v. BOE*." (Initial Statement of Reasons, p. 14.) Therefore, there is not a material difference in the economic impact of a county assessor determining that petroleum refinery property (land, improvements, and fixtures) constitutes a single appraisal unit for measuring declines in value, under RTC section 51(d) or Rule 474 (after it is re-adopted and effective), when persons in the marketplace commonly buy and sell refinery property as a unit, as the Board confirmed that they currently do. In addition, neither Ms. Reheis-Boyd's letter nor Mr. Becker's testimony identify any specific economic impact from county assessors applying Rule 474, instead of applying the California Supreme Court's binding precedential opinion regarding the proper appraisal unit to be used to measure declines in value of petroleum refinery property, under current California property tax law, including RTC section 51(d), to determine the proper appraisal unit to measure declines in value of petroleum refinery property. Therefore, the Board has adequately and correctly assessed the economic impact of the re-adoption of Rule 474.

Responses to Comments Regarding the Board's Analysis of the Tax Effect of Treating Petroleum Refinery Property as One Appraisal Unit

First, pages seven and eight of the initial statement of reasons explain that the Board previously determined that its initial adoption of Rule 474, in 2006, changed the valuation of petroleum refinery property. At the time, the Board estimated that the initial adoption of Rule 474 would result in at least a $140 million annual increase in the assessed value of all of California's petroleum refineries and at least a $1.4 million increase in the taxes paid by the refineries' owners. And, the California Supreme Court invalidated the Board's initial adoption of Rule 474 on procedural grounds because the Court agreed with the trial court and Court of Appeal that the Board could not explain why its 2006 calculation of the tax effect of the Board's initial adoption of Rule 474 represented "'empirically or conceptually, a valid or reasonable way to estimate the amount of fixture depreciation that would be offset by appraising land and fixtures as a single unit.' (*WSPA v. BOE*, p. 430.); and '[T]he Board's calculation failed to consider prior land appreciation and the full tax impact that would occur if land were valued at actual market value rather than adjusted base year value.' (*Ibid*.)" (Initial Statement of Reasons, p. 8

[quoting *WSPA v. BOE*].) Therefore, as part of the re-adoption of Rule 474, the Board made a significant effort to determine the "tax effect" of valuing California's petroleum refineries' fixtures as part of the same appraisal unit with their land and improvements under RTC section 51(d) and Rule 474, instead of valuing the fixtures as a separate appraisal unit under Rule 461(e), the Board included its actual calculations of the tax effect in Attachment F to the initial statement of reasons, and the Board summarized its findings from those calculations in the initial statement of reasons.

However, the Board has correctly determined that the re-adoption of Rule 474 does not substantially change the valuation of petroleum refinery property for purposes of measuring declines in value under current California property tax law, including RTC section 51(d) and Rule 324, as interpreted by the California Supreme Court in *WSPA v. BOE*, as explained above. So, the re-adoption of Rule 474 will not change the assessed value of any California petroleum refinery or increase the taxes paid by any California petroleum refinery owner under current law. And, the "tax effect" shown in the calculations in Attachment F to the initial statement of reasons and discussed in the initial statement of reasons is not an economic impact caused by the Board's re-adoption of Rule 474 within the meaning of the APA.

Second, the initial statement of reasons explains that:

> Although the Board has determined that there is no economic impact associated with the re-adoption of Rule 474 due to the mandates of RTC section 51(d), the Board is aware that fixture depreciation[10] can be offset by appreciation[11] in land and improvements when petroleum refinery property (land, improvements, and fixtures) is valued as a single appraisal unit, as the California Supreme Court indicated in *WSPA v. BOE*. Therefore, the Board recognizes that there is sometimes an increase in the total assessed value of petroleum refinery property when fixtures are valued as part of the same appraisal unit with land and improvements under RTC section 51(d) and Rule 474, instead of valued as a separate appraisal unit under Rule 461(e). The Board also recognizes that property taxes increase by one percent of each increase in assessed value.
>
> As a result, Board staff determined that it needed to obtain the available data regarding the market values and adjusted base year values for petroleum refinery land, improvements, and fixtures so that Board staff could accurately compare the total assessed value of a petroleum refinery when its fixtures are valued as a separate appraisal unit under Rule 461(e) and valued as part of the same appraisal unit with land and improvements under Rule 474. Therefore, Board staff contacted the California Assessors' Association and requested that the county assessors provide

[10] In this context, fixture "depreciation" is measured by subtracting market value from adjusted base year value.
[11] In this context, "appreciation" in land and improvements is measured by subtracting adjusted base year value from market value.

> Board staff with the available data for 2009 through 2013 without identifying specific petroleum refineries. In response, the California Assessors' Association provided all of the data for nine petroleum refineries for 2009-2013, and all the data for one additional petroleum refinery for 2009-2012, including many of California's largest refineries.

The initial statement of reasons also explains that "Board staff subsequently reviewed the available data" and "determined what the assessed values would be for 2009 through 2013, under RTC section 51(d) and Rule 474, and under Rule 461(e), for each of the 10 California petroleum refineries for which data" was available. And, Board staff determined that "the data did not indicate that valuing petroleum refinery fixtures as part of the same appraisal unit with land and improvements under RTC section 51(d) and Rule 474, instead of valuing fixtures as a separate appraisal unit under Rule 461(e), has a consistent tax effect in any given year or from year-to-year."

The initial statement of reasons further explains that, based upon the available data:

> [Board] staff determined that the owners of one of the 10 refineries would not pay higher property taxes under RTC section 51(d) and Rule 474, than under Rule 461, in any of the five years. [Footnote omitted.] Staff also determined that the owners of nine of the 10 refineries would pay higher property taxes under RTC section 51(d) and Rule 474, than under Rule 461, in at least two of the five years. Specifically, staff determined that:
>
> - The owners of two of the 10 refineries would pay higher property taxes under RTC section 51(d) and Rule 474, than under Rule 461, in two of the five years;
> - The owners of two of the 10 refineries would pay higher property taxes under RTC section 51(d) and Rule 474, than under Rule 461, in three of the five years;
> - The owners of three of the 10 refineries would pay higher property taxes under RTC section 51(d) and Rule 474, than under Rule 461, in four of the five years; and
> - The owners of two of the 10 refineries would pay higher property taxes under RTC section 51(d) and Rule 474, than under Rule 461, in all five years. [Footnote omitted.]
>
> In addition, Board staff determined that the owners of 9 of the 10 refineries would collectively pay the following additional property taxes for 2009 through 2013 if their refineries were valued under RTC section 51(d) and Rule 474, rather than under Rule 461, and determined that the additional taxes represented the following percentage increases in their collective property taxes for each year:
>
> | | | |
> |---|---|---|
> | 2009: | $4,633,805 | 2.78% |
> | 2010: | $5,221,876 | 3.79% |

2011:	$5,159,918	3.46%
2012:	$4,045,140	2.52%
2013:	$2,816,552	2.40% [Footnote omitted]

Ms. Reheis-Boyd's letter states that WSPA was able to determine that all 10 of the petroleum refineries the Board analyzed are "within Los Angeles and Contra Costa County" (Ms. Reheis-Boyd's Letter, p. 8), which are the two counties that contain 9 of California's 10 largest petroleum refineries based upon their refining capacity as shown in the table from the "Energy Almanac" published by the California Energy Commission, included in the initial statement of reasons. Ms. Reheis-Boyd's letter states that WSPA was "able to match the Board's 10 Refineries A through J to their owners." (Ms. Reheis-Boyd's Letter, p. 8.) Ms. Reheis-Boyd's letter also states that WSPA was able to specifically determine that the "Carson refinery is 'refinery A' on the attachment F" (Ms. Reheis-Boyd's Letter, p. 9), and the Carson refinery is among the three largest refineries in California based upon their refining capacity as shown in the table from the "Energy Almanac," included in the initial statement of reasons.

Furthermore, Exhibit 2 to Ms. Reheis-Boyd's letter indicates that WSPA determined that all 10 of the refineries for which data was available had at least 100,000 crude barrels of capacity. And, the table from the "Energy Almanac," included in the initial statement of reasons, shows that there were only 9 refineries in California with crude oil capacity of at least 100,000 barrels per day as of October 2012.

The analysis provided in the initial statement of reasons clearly indicates the Board has made a reasoned effort to initially assess the effect of valuing all of California's petroleum refineries' fixtures as part of the same appraisal unit with the petroleum refineries' land and improvements under RTC section 51(d) and Rule 474, instead of valuing the fixtures as a separate appraisal unit under Rule 461(e), for a five year period. The Board used an empirically and conceptually valid and reasonable way to estimate the amount of fixture depreciation that would be offset by appraising petroleum refinery land, improvements, and fixtures as a single appraisal unit using the available data for 10 petroleum refineries, which Ms. Reheis-Boyd's letter and the Energy Almanac indicate included 8 of California's 9 largest refineries, which are located in Los Angeles and Contra Costa Counties. The Board's calculations specifically considered prior land and improvement appreciation and the full tax impact of offsetting fixture depreciation against land and improvement appreciation for all of the 10 refineries for which data was available and did so for a five-year period as to nine of the refineries and for a four-year period for the remaining refinery. Therefore, contrary to Ms. Reheis-Boyd and Mr. Becker's assertions, the Board's calculations provide a reader with an understanding of what the taxes on a representative refinery would have been under the formerly applicable Rule 461(e) and what the taxes would be under RTC section 51(d) and new Rule 474 based upon evidence that was identified in the initial statement of reasons. And, the Board's calculations, in Attachment F to the initial statement of reasons, provide readers with a valid and reasonable way to make their own estimates of the amount of fixture depreciation that would be offset by valuing a petroleum refinery's fixtures as part of the same appraisal unit with the petroleum refinery's land and improvements under

RTC section 51(d) and Rule 474, instead of valuing the fixtures as a separate appraisal unit under Rule 461(e).

Third, the Board was not able to make an estimate of the amount of fixture depreciation that would be annually offset by appraising all of California's petroleum refineries' land, improvements, and fixtures as a single appraisal unit or the annual tax effect of offsetting all of the refineries' fixture depreciation against their land and improvement appreciation. This is because the California Assessors' Association did not provide the Board with data for all of California's petroleum refineries and the available data did not indicate that valuing petroleum refinery fixtures as part of the same appraisal unit with land and improvements under RTC section 51(d) and Rule 474, instead of valuing fixtures as a separate appraisal unit under Rule 461(e), has a consistent tax effect in any given year or from year-to-year, as explained in the initial statement of reasons. Also, there is nothing in Ms. Reheis-Boyd's letter or Mr. Becker's testimony to indicate that the Board misanalysed the available data in this regard. And, Ms. Reheis-Boyd's letter and Mr. Becker's testimony do not identify a reasonable methodology the Board could have used to estimate the amount of fixture depreciation that would be annually offset by valuing all of California's petroleum refineries' land, improvements, and fixtures as a single appraisal unit or the annual tax effect of offsetting all of the refineries' fixture depreciation against their land and improvement appreciation based upon the available data.

Fourth, the Board assesses pipelines, flumes, canals, ditches, and aqueducts lying within two or more counties, property, except franchises, owned or used by regulated railway, telegraph, or telephone companies, car companies operating on railways in the state, and companies transmitting or selling gas or electricity, and electric generation facilities with a generating capacity of 50 megawatts or more that are owned or operated by an electrical corporation (collectively "state-assessed property") under section 19 of Article XIII of the California Constitution and RTC sections 721 and 721.5. Therefore, the Board did have the resources and expertise to determine what the assessed values would be for 2009 through 2013, under RTC section 51(d) and Rule 474, and under Rule 461(e), for each of the 10 California petroleum refineries for which data was available. However, all taxable property, except state-assessed property, is assessed by the *county assessors* under RTC section 404, including petroleum refinery property. As a result, the Board does not have experience directly valuing petroleum refinery property, it does not have its own historical data regarding the market values and adjusted base year values for the land, improvements, and fixtures for California's petroleum refineries, and it does not currently have the resources, expertise, or the tax and other financial information needed to accomplish the substantial task of independently determining the market values and adjusted base year values for the land, improvements, and fixtures for all of California's petroleum refineries on any lien date, much less multiple lien dates.

Also, taxpayers' property tax and related financial information is confidential. (See, e.g., Gov. Code, §§ 15619 and 15641 prohibiting the Board from disclosing information regarding the "business affairs of any company that . . . is not required by law to be reported to the Board" and prohibiting the Board from disclosing "appraisal data"

obtained during surveys of county assessors' assessment practices, respectively. See, also, RTC, § 451 providing that "[a]ll information requested by the assessor or furnished in the property statement shall be held secret by the assessor.") The APA does not expressly protect this type of confidential taxpayer information from being publicly disclosed when it is provided to an agency as part of a comment on a proposed regulation. Instead, the APA requires agencies to maintain a rulemaking file and make the rulemaking file available to the public for inspection and copying during regular business hours. (Gov. Code, § 11347.3, subd. (a).) And, as relevant here, the APA expressly requires the rulemaking file to include:

- "All data and other factual information, any studies or reports, and written comments submitted to the agency in connection with the adoption, amendment, or repeal of the regulation"; and
- "All data and other factual information, technical, theoretical, and empirical studies or reports, if any, on which the agency is relying in the adoption, amendment, or repeal of a regulation, including any economic impact assessment or standardized regulatory impact analysis as required by Section 11346.3." (Gov. Code, § 11347.3, subd. (b)(6) and (7).)

In addition, the Board had no reason to expect that petroleum refinery owners would provide data to support the Board's re-adoption of a rule they generally oppose. Therefore, the Board did not directly solicit confidential information from or about specific taxpayers that the APA could require to be disclosed to the public.

Instead of directly soliciting confidential information from or about specific taxpayers, the Board determined that it would be more reasonable for the Board to contact the California Assessors' Association and request that the California Assessors' Association:

- Collect the county assessors' available historical data regarding the market values and adjusted base year values for the land, improvements, and fixtures for California's petroleum refineries for 2009 through 2013;
- Aggregate the data provided by the county assessors; and
- Provide the aggregated data to the Board without identifying specific petroleum refineries.

That way, the Board could obtain the historical data it needed to determine the "tax effect" of valuing California's petroleum refineries' fixtures as part of the same appraisal unit with their land and improvements under RTC section 51(d) and Rule 474, instead of valuing the fixtures as a separate appraisal unit under Rule 461(e), without having to unnecessarily publicly disclose the specific taxpayers to which the data relates or rely on petroleum refinery owners to provide data to support the re-adoption of a rule they generally oppose.

Furthermore, the Board did provide copies of the initial statement of reasons, including the Board's economic impact assessment, and the attachments to the initial statement of reasons to CalTax and WSPA on September 12, 2014, and gave them an opportunity to

review the documents and provide input to the Board before the Board started the formal rulemaking process to re-adopt Rule 474. However, after reviewing the documents, CalTax and WSPA did not submit data the Board could use to determine the tax effect of valuing California's petroleum refineries' fixtures as part of the same appraisal unit with their land and improvements under RTC section 51(d) and Rule 474, instead of valuing the fixtures as a separate appraisal unit under Rule 461(e). The Board also published a notice on October 24, 2014, that generally solicited public comments regarding the Board's proposed re-adoption of Rule 474 in accordance with the APA, which gave all the interested parties, including CalTax and WSPA, an opportunity to submit such data. However, CalTax's comments in response to the notice did not provide any data (as discussed above). And, WSPA's comments in response to the notice, both in Ms. Reheis-Boyd's letter, which was submitted the day before the December 18, 2014, public hearing, and in Mr. Becker's testimony the following day, did not provided any usable data (as discussed below).

Fifth, the APA requires the proposed adoption of a new regulation, such as Rule 474, to be based upon "adequate information" and the APA requires an agency to consider information supplied by interested parties in proposing and adopting a new regulation. (Gov. Code, §§ 11346.3, subd. (a)(1) & (2), and 11346.9, subd. (a)(3)-(5).) The APA does not expressly mandate that a state agency independently value county-assessed property. The APA does not expressly require a state agency to independently verify data provided by interested parties, such as the California Assessors' Association. And, the Board disagrees with Ms. Reheis-Boyd's letter and Mr. Becker's testimony to the extent they suggest that the California Supreme Court's opinion in WSPA v. BOE interprets the APA as requiring a state agency to independently value county-assessed property or verify data provided by interested parties under the current circumstances where the value or other data does not relate to the "economic impact" of the Board's proposed regulatory action within the meaning of the APA.

Sixth, as explained in the initial statement of reasons and in this final statement of reasons, the Board's re-adoption of Rule 474 is based upon adequate information. The Board carefully considered all the information provided by all the interested parties regarding the Board's re-adoption of Rule 474, including the historical data provided by the California Assessors' Association. The Board had no reason to question the accuracy of the historical data the California Assessors' Association provided at the time that the Board prepared its initial statement of reasons. Ms. Reheis-Boyd's letter did not provide other data regarding the specific market values and adjusted base year values for any specific California petroleum refinery's land, improvements, and fixtures, as of a specific valuation date, that the Board could use to compare the total assessed value of an actual petroleum refinery when its fixtures are valued as a separate appraisal unit and valued as part of the same appraisal unit with its land and improvements. Mr. Becker's testimony did not indicate that WSPA would be likely to provide such data, even if the Board delayed the re-adoption of Rule 474 in order to give WSPA additional time to do so. And, as discussed further below, neither Ms. Reheis-Boyd's letter nor Mr. Becker's testimony were sufficient to establish that there are significant errors throughout "all" of the data provided by the California Assessors' Association, as they claim. Therefore,

there initially was and there still currently is no data available, other than the historical data provided by the California Assessors' Association, that the Board can reasonably use to compare the total assessed value of one or more actual petroleum refineries when their fixtures are valued as a separate appraisal unit and valued as part of the same appraisal unit with their land and improvements. And, it is still reasonable to conclude that the Board's analysis of all the historical data provided by the California Assessors' Association does provide a reader with a sufficient understanding of what the taxes on a representative refinery would have been under the formerly applicable Rule 461(e) and what the taxes would be under current RTC section 51(d) and new Rule 474.

In addition, Mr. Flessner's letter in support of the Board's re-adoption of Rule 474 explains that there is little data for county assessors to use to establish separate fair market values for refinery land, improvements and equipment. It explains that the buyer and seller of a refinery are primarily interested in the income that is generated by the refinery, as a whole. It also explains that the income potential of a petroleum refinery is dictated by the installed processing equipment, however, because the land, improvements, and fixtures at refineries are physically and functionally integrated income resulting from the refinery cannot be easily allocated between these elements. For this reason, refinery operations planning, economic analysis, and management accounting do not allocate income to classes of assets, such as land, improvements, and equipment, rather, income is measured and attributed to a refinery as a single economic unit.

Furthermore, Mr. Flessner's letter explains that it is necessary to value refineries under the income approach because the income approach is used by buyers and sellers of refineries to establish the selling price in transactions. It explains that the justification for requiring a separate appraisal unit for fixtures in order to account for fixture depreciation[12] does not exist under the income approach. This is because the refinery income stream and the resulting value already account for a lower level of performance that would result from physical depreciation of a refinery's fixtures by wear and tear or obsolescence. In addition, the income approach accounts for costs of maintenance and replacement that refineries incur to mitigate the effects of physical depreciation and obsolescence. Therefore, there is a factual basis to conclude that the Board could only reasonably and independently verify (or audit) all the historical data provided by the California Assessors' Association regarding the 10 refineries included in Attachment F to the Board's initial statement of reasons if the Board was able to:

1. Identify each of the refineries;
2. Obtain sufficiently detailed information regarding each of the same California refineries' income, expenses, assets, and adjusted base year values as of the 2009 through 2013 lien dates;
3. Compute the present worth of each refinery's future income stream, under the income approach prescribed by Rule 8, *The Income Approach to Value*, and explained by Assessors' Handbook Sections 501, *Basic Appraisal*, and 502, *Advanced Appraisal*, as of each lien date; and

[12] In this context, fixture "depreciation" refers to the physical deterioration or obsolescence of a fixture.

4. Allocate each refinery's value, as of each lien date, to each refinery's land, improvements, and fixtures.

However, the Board does not have sufficiently detailed information or resources to independently verify the data provided by the California Assessors' Association. Although the petroleum refinery owners' have their own data, Mr. Becker's testimony indicated that WSPA would be unlikely to provide such data, even if the Board delayed the re-adoption of Rule 474 in order to give WSPA additional time to do so. And, Mr. Becker's testimony provides good reason to conclude that WSPA would still continue to maintain that the Board's refinery values or allocated land, improvement, and fixture values, or both are "wrong," even if the Board did have sufficient information and resources and did independently verify the data provided by the California Assessors' Association. Therefore, under these circumstances, the Board does not agree that the Board was required to independently verify the data provided by the California Assessors' Association either before or after proposing to re-adopt Rule 474 in order to substantially comply with APA.

Seventh, in the initial statement of reasons, the Board referred to the June 2013 sale of BP's Carson, California refinery and related logistics and marketing assets in the region to Tesoro Corporation as an example of a recent sale of an entire refinery as a unit. However, the Board had no basis to identify any of the petroleum refineries included in Attachment F to the Board's initial statement of reasons, including Refinery A in Attachment F, when Board staff assessed the effect of valuing California's petroleum refineries' fixtures as part of the same appraisal unit with the petroleum refineries' land and improvements under RTC section 51(d) and Rule 474, instead of valuing the fixtures as a separate appraisal unit under Rule 461(e), using the historical data provided by the California Assessors' Association. And, the Board had no basis to determine that Refinery A in Attachment F to the Board's initial statement of reasons was the same Carson refinery included in the June 2013 sale prior to receiving Ms. Reheis-Boyd's letter the day before the December 18, 2014, public hearing. Therefore, even assuming that Refinery A is the Carson refinery (as stated in Ms. Reheis-Boyd's letter), the Board could not have used the June 2013 sale to verify the accuracy of the data the California Assessors' Association provided for Refinery A before the Board performed its assessment of the effect of valuing California's petroleum refineries' fixtures as part of the same appraisal unit with the petroleum refineries' land and improvements under RTC section 51(d) and Rule 474, instead of valuing the fixtures as a separate appraisal unit under Rule 461(e), for a five year period, using the historical data provided by the California Assessors' Association.

Eight, under Rule 8, the present worth of a specific petroleum refinery's future income stream depends upon the size, shape, and duration of the estimated stream. Therefore, the value of a specific petroleum refinery, under the income approach, depends upon a number of factors that increase and decrease the size, shape, and duration of its future income stream, as of a specific valuation date. These factors include, but are not limited to, fluctuations in:

- The cost of the petroleum refinery's crude oil;
- The cost of producing its specific combination of petroleum products;
- The amount of each specific petroleum product produced; and
- The prices for the specific combinations and amounts of petroleum products the refinery produces.

Also, changes in market conditions do not necessarily have the same effect on all of California's petroleum refineries due to a number of factors, such as variations in each refinery's production potential during the year and from year-to-year, the source(s) and quality of each refinery's crude oil, and the size of each refinery relative to the other refineries (economies of scale). As a result, the value of a specific petroleum refinery, as determined under the income approach, will generally fluctuate from one valuation date to another, and the fluctuation may not necessarily be consistent with the fluctuations in the values of other refineries on the same valuation dates.

The actual sales price (or total consideration) paid solely for the Carson refinery in the June 2013 sale of BP's Carson refinery and related logistics and marketing assets in the region to Tesoro Corporation would be evidence of how BP (the seller) and Tesoro Corporation (the buyer) valued the Carson refinery in June 2013. And, assuming the sale was truly an open market transaction, that June 2013 value could be "used" as an indicator of the Carson refinery's value on the January 1, 2013, lien date, under the comparable sales approach, because RTC section 402.5's prohibition against using comparable sales that are not "near in time to the valuation date," meaning "any sale more than 90 days after the valuation date," to value property under the comparable sales approach, does not apply to a sale of the subject property itself, as provided in Rule 324, subdivision (d).

However, BP's June 2013 sales of the Carson refinery and related logistics and marketing assets in the region may not have been an "open market" transaction that can be used to reliably establish the "actual value" of property under Rule 2, *The Value Concept*. This is because BP's divestment of the Carson refinery and related logistics and marketing assets in the region was the last step BP *needed* to take to complete the strategic refocusing of its United States fuels portfolio, as explained in BP's press release (included as Attachment E to the initial statement of reasons). And, Tesoro Corporation appears to have been in a unique position to take advantage of BP's desire to complete the strategic refocusing of its business because the Carson refinery is adjacent to Tesoro Corporation's Wilmington refinery, Tesoro Corporation planned to integrate the two refineries, and Tesoro Corporation expected to realize significant operational synergies from the integration, as indicated in Tesoro Corporation's Form 10-K referred to in Ms. Reheis-Boyd's letter. Therefore, it is possible that the price paid solely for the Carson refinery in the June 2013 sale may not establish the actual value of the Carson refinery in accordance with Rule 2.

Also, the June 2013 sale of BP's Carson refinery and related logistics and marketing assets in the region to Tesoro Corporation was part of a larger bundled transaction. The available information regarding the sale of BP's Carson refinery and related logistics and

marketing assets in the region to Tesoro Corporation, including Tesoro Corporation's Form 10-K referred to in Ms. Reheis-Boyd's letter, is somewhat general and does not contain the detail necessary to determine exactly what consideration Tesoro Corporation paid solely for the Carson refinery. The available information regarding the June 2013 sale does not allocate any of the 2013 sales price paid for the Carson refinery and related logistics and marketing assets in the region to the refinery's land, improvements, and fixtures. And, the available information regarding the June 2013 sale does not indicate whether and to what extent the internal and external factors affecting the Carson refinery's value, under both the comparable sales approach and the income approach, changed between the January 1, 2013, lien date and the June 2013 sale. Therefore, even assuming that Refinery A in Attachment F to the initial statement of reasons is the Carson refinery, the available information regarding the June 2013 sale is insufficient for the Board to precisely and independently determine the value of Refinery A on the January 1, 2013 lien date, under the comparable sales approach, much less allocate that value to Refinery A's land, improvements, and fixtures. And, the available information regarding the June 2013 sale is insufficient to value Refinery A, under the income approach, or verify the accuracy of values determined for Refinery A, under the income approach.

In addition, on page 9 of her letter, Ms. Reheis-Boyd recognizes that Tesoro Corporation purchased a bundle of assets, including the Carson refinery, as part of the June 2013 sale, and she suggests that the sales price of the refinery can be determined by subtracting the price at which "Tesoro Corporation [subsequently] sold the non-refinery assets to a related entity" from the "$1.075 billion" of "cash proceeds" BP's press release indicates that it received for all the "assets." However, the Board does not agree that the approach recommended in Ms. Reheis-Boyd's letter and reiterated in Mr. Becker's testimony is appropriate.

This is because the June 2013 sale was a complex, bundled transaction, and it would not be reasonable to rely solely on the amount of "cash proceeds" reported in BP's press release to determine the total consideration paid for the assets. This is because related party transactions, such as Tesoro Corporation's sale of the non-refinery assets, are not generally the type of "open market" transactions that can be used to reliably establish the "actual value" of property under Rule 2. And, even if the related party sale at issue did establish the "actual value" of property, page 39 of Tesoro Corporation's Form 10-K indicates that the sale at issue occurred in December 2013, which means that the sale was not near in time to the June 2013 sale, much less the January 1, 2013, lien date. Therefore, the information the Board currently has available regarding the June and December 2013 sales is not adequate to precisely determine the value of the Carson refinery on the January 1, 2013, lien date. And, as a result, the information the Board currently has available regarding the June 2013 sale does not conclusively establish that the 2013 Refinery A data provided by the California Assessors' Association is inaccurate, even assuming that Refinery A is the Carson refinery.

Moreover, the June 2013 sale is less near in time to the 2009 through 2012 lien dates than it is to the January 1, 2013, lien date. So, even assuming the Board knew the actual sales price paid solely for the Carson refinery in the June 2013 sale and that the Carson

refinery was Refinery A, the Board still could not reasonably use the June 2013 sales price, by itself, to determine the values of the Carson refinery on the 2009 through 2012 lien dates or verify whether the data provided by the California Assessors' Association for Refinery A for the 2009 through 2012 lien dates is inaccurate. And, the actual sales price paid solely for the Carson refinery in the June 2013 sale, even if known, could not reasonably be used, by itself, to value Refineries B through J in Attachment F to the initial statement of reasons for any lien date. Therefore, the information the Board currently has available regarding the June 2013 sale does not establish that the data regarding Refinery A for the 2009 through 2012 lien dates and Refineries B through J for the 2009 through 2013 lien dates provided by the California Assessors' Association is "wrong," as suggested in Ms. Reheis-Boyd's letter and Mr. Becker's testimony.

Ninth, a petroleum refinery's capacity to produce petroleum products, as measured in crude barrels of oil per day, is a factor that is relevant to measuring the size and therefore the value of that refinery. However, the income being derived from a specific petroleum refinery and the value of the refinery that can be derived from that income, under the income approach, is not solely dependent on the refinery's capacity to produce petroleum products, as measured in crude barrels of oil per day. Therefore, the capacity of a refinery, measured in crude barrels of oil per day, by itself, is not sufficient to establish the value of that refinery on a particular valuation date, and dividing a particular amount by a refinery's capacity, as measured in crude barrels of oil per day, by itself, does not establish whether the amount represents the refinery's value on a particular valuation date.

In addition, the information from the Energy Almanac, included in Attachment A to the initial statement of reasons, explains that "[e]ach day approximately two million barrels (a barrel is equal to 42 U.S. gallons) of petroleum are processed [by California's petroleum refineries] into a variety of products, with gasoline representing about half of the total product volume." The California specific information from the United States Energy Commission, included in Attachment D to the initial statement of reasons, shows that there were fluctuations in the actual production of petroleum products at California's petroleum refineries from 2009 to 20013. And, the Board is aware that the market prices for crude oil and the petroleum products that a petroleum refinery can produce from crude oil are volatile, and have changed from 2009 through 2013. Therefore, information regarding Refineries A through J's "income streams" on the 2009 through 2013 lien dates (i.e., information about each petroleum refinery's actual production volumes, the types and quantities of products being produced, and the fluctuating market values of those products during the relevant periods) would be more useful in determining the refineries' values, than the refineries' capacity to produce petroleum products, as measured in crude barrels of oil per day. And, dividing each petroleum refinery's low and high values during a five-year period, as provided by the California Assessors' Association, by a stagnant crude barrels of refinery capacity number, only illustrates that the values of the refineries fluctuated somewhat, which is obvious from looking at the values themselves. It does not tend to indicate whether the fluctuations in the values provided by the California Assessors' Association reflect fluctuations in the refineries' income streams.

Furthermore, neither Ms. Reheis-Boyd's letter nor Mr. Becker's comments identify any of the refineries included in Exhibit 2 to Ms. Reheis-Boyd's letter, other than the Carson refinery. So, neither Ms. Reheis-Boyd's letter nor Mr. Becker's comments enable the Board to verify whether Exhibit 2 uses the correct crude barrels of refinery capacity number for each refinery. Also, Exhibit 2 to Ms. Reheis-Boyd's letter provides that "252,000" is the crude barrels of refinery capacity (per day) number for Refinery A, which the letter identifies as the Carson refinery. However, it is not clear what source this number was derived from. The information from the Energy Almanac, included in Attachment A to the initial statement of reasons, provides that the Carson refinery's crude oil capacity is 240,000 barrels per day and BP's press release regarding the June 2013 sale of the Carson refinery and related logistics and marketing assets in the region to Tesoro Corporation indicates that the Carson refinery's crude oil capacity is 266,000 barrels per day (the same as p. 4 of Tesoro Corporation's Form 10-K). Therefore, the Board is not certain that any of the calculations provided in Exhibit 2 to Ms. Reheis-Boyd's letter are reliable.

Tenth, the Board is aware of the Nelson Complexity Index (NCI), which W.L. Nelson developed to compare the costs of various process units, to the cost of a crude distillation unit. The index is an attempt to quantify the relative cost of a refinery based on the added cost of various process units. A complexity factor of 1 is assigned to the distillation unit, and the index rates all other process units' complexity factors in terms of their cost relative to this unit. For example, a unit that costs three times as much as a distillation unit would have a factor of 3. The total complexity rating of a refinery is calculated by multiplying the complexity factor for each downstream unit by the percentage of crude oil it processes, then totaling these individual factors.

The complexity factor valuation approach is essentially a cost-based methodology for measuring refinery value that uses a proxy for unit costs, which is a refinery's complexity factor multiplied by its production capacity. The complexity factor approach is used in the industry to derive a market "indicator" of value per unit of cost. However, the complexity factor approach has limitations. For example, the complexity factor approach ignores costs associated with non-production units, such as storage tanks, it ignores variations in costs of production based upon economies of scale, and it does not take into account how much of a refinery's production capacity is able to be utilized and is actually being utilized at a given time.

The complexity factor approach is also dependent on the level of detail used to quantify a refinery's process units, and quantify the percentage of the refinery's total crude oil capacity represented by each process. Also, the amounts actually paid for refineries measured in barrels per day of capacity adjusted for complexity fluctuate from year-to-year due to a number of market factors. Therefore, a refinery's complexity factor, at any given time, has to be determined by quantifying the refinery's process units at that time. A refinery's complexity factor can change if its process units change. And, the complexity factor valuation approach only produces an educated guess about a refinery's value, under the cost-approach, on a specific valuation date. (See, e.g., Daniel Johnston's March 18, 1996, article published on the Oil & Gas Journal's website, entitled "Refining

Report Complexity index indicates refinery capability, value," for general information about the NCI and the complexity factor valuation approach.)

In addition, the income being derived from a specific petroleum refinery and the value of the refinery that can be derived from that income, under the income approach, is not solely dependent on the refinery's capacity to produce petroleum products, as measured in crude barrels of oil per day as adjusted for complexity. And, there is no evidence to establish that the complexity factor valuation approach is more reliable than the income approach to accurately determine the value of an operating petroleum refinery on a specific valuation date. Therefore, the capacity of a refinery, measured in crude barrels of oil per day as adjusted for complexity, by itself, is not sufficient to conclusively establish the value of that refinery on a particular valuation date or to show that a value for that refinery, determined under the income approach, is "wrong," as suggested in Ms. Reheis-Boyd's letter.

As previously explained, information regarding Refineries A through J's "income streams" on the 2009 through 2013 lien dates would be more useful in determining the refineries' values, than the refineries' capacity to produce petroleum products, as measured in crude barrels of oil per day as adjusted for complexity. And, dividing each petroleum refinery's low and high fixture values (not total values) during a five-year period, as provided by the California Assessors' Association, by a stagnant crude barrels of refinery capacity number adjusted for complexity, only illustrates that the fixture values fluctuated somewhat, which is obvious from looking at the values themselves. It does not prove that there were no fluctuations in the refineries' income streams and total values, particularly because the complexity factor approach does not account for a number of variables that make each refinery unique and affect each refinery's income stream, and, as a result, it cannot reliably establish that the high and low fixture values are inaccurate. In fact, differences resulting from dividing the same petroleum refinery's low and high fixture values during a five-year period, by a stagnant crude barrels of refinery capacity number adjusted for complexity, may actually indicate that the stagnant number is inaccurate for the low period, the high period, or both periods because there were in fact fluctuations in the refineries' capacities to produce petroleum products, as measured in crude barrels of oil per day as adjusted for complexity.

Furthermore, neither Ms. Reheis-Boyd's letter nor Mr. Becker's comments identify any of the refineries included in Exhibit 1 to Ms. Reheis-Boyd's letter, other than the Carson refinery. They do not identify any of the refineries' refining processes, they do not quantify the refineries' process units, they do not identify the NCI factors assigned to the refineries' various processes, and they do not identify the percentage of each refinery's total crude oil capacity represented by each of the refinery's processes. So, neither Ms. Reheis-Boyd's letter nor Mr. Becker's comments enable the Board to verify whether Exhibit 1 uses the correct crude barrels of refinery capacity number for each refinery (as previously discussed) or the correct complexity number as a multiplier for each refinery to determine each refinery's complexity barrels of refinery capacity number as of any lien date. Therefore, the Board is not certain that any of the calculations provided in Exhibit 1 to Ms. Reheis-Boyd's letter are reliable and that they accurately account for all the

differences in the refineries' complexity. And, Exhibit 1 does not establish that all the data regarding Refineries A through J for the 2009 through 2013 lien dates provided by the California Assessors' Association is "wrong," as suggested in Ms. Reheis-Boyd's letter.

Eleventh, when valuing a petroleum refinery under the income approach prescribed by Rule 8, subdivision (c):

> The amount to be capitalized is the net return which a reasonably well informed owner and reasonably well informed buyers may anticipate on the valuation date that the taxable property existing on that date will yield under prudent management and subject to such legally enforceable restrictions as such persons may foresee as of that date. Net return, in this context, is the difference between gross return and gross outgo. Gross return means any money or money's worth which the property will yield over and above vacancy and collection losses, including ordinary income, return of capital, and the total proceeds from sales of all or part of the property. Gross outgo means any outlay of money or money's worth, including current expenses and capital expenditures (or annual allowances therefor) required to develop and maintain the estimated income. Gross outgo does not include amortization, depreciation, or depletion charges, debt retirement, interest on funds invested in the property, or rents and royalties payable by the assessee for use of the property. . . .

Mr. Flessner's letter correctly explains that "the justification for requiring a separate appraisal unit for fixtures in order to account for fixture depreciation does not exist under the income approach. This is because the refinery income stream and the resulting value account for a lower level of performance that would result from physical depreciation of a refinery's fixtures by wear and tear or obsolescence. In addition, the income approach accounts for costs of maintenance and replacement that refineries incur to mitigate the effects of physical depreciation and obsolescence."

When valuing a petroleum refinery under the reproduction or replacement cost approach prescribed by subdivision (e) of Rule 6, *The Reproduction and Replacement Cost Approaches to Value*, reproduction or replacement cost new of depreciable assets is reduced for physical deterioration and other forms of depreciation or obsolescence. And, it is generally the case that once a depreciable asset is placed in service, the fair market value of the asset is less than the asset's reproduction or replacement cost new, as determined under the reproduction or replacement cost approach, which treats depreciable assets as a separate appraisal unit.

Neither Ms. Reheis-Boyd's letter nor Mr. Becker's testimony provide any basis to conclude that the refinery market values in the data provided by the California Assessors' Association were determined using the reproduction or replacement cost approach. Instead, Mr. Flessner's letter and other comments, Ms. Hooley's comments, and Mr. Yu's comments indicate that the market values of the Contra Costa County refineries included

in the data provided by the California Assessors' Association were determined by using the income approach, not the replacement cost new approach. And, their comments make it likely that the market values of the other refineries included in Attachment F to the initial statement of reasons were determined using the same approach. Therefore, it does not seem likely that fixture "depreciation," meaning physical deterioration and other forms of depreciation or obsolescence, was part of the calculations of the refinery market values included in Attachment F to the initial statement of reasons. Instead, it seems much more likely that each refinery's total market value, as of each lien date, was determined using the income approach, and then each refinery's total market value was allocated to its land, improvements, and fixtures as of the same lien date. As a result, a reasonable person would want to review the way each refinery's total market value was determined under the income approach for each specific lien date at issue and how each refinery value was allocated to each refinery's fixtures as of the same lien dates in order to determine whether the allocated fixture values were accurate. Thus, it is not reasonable to conclude that any of the refineries' fixture market values included in Attachment F to the initial statement of reasons are "wrong" solely because the fixture's market values exceed their adjusted base year values.

Twelfth, the use of inaccurate data will affect the accuracy of any calculation. However, as explained above, neither Ms. Reheis-Boyd's letter nor Mr. Becker's testimony, provide a concrete factual basis to establish that there are significant or substantial errors in any of the data provided by the California Assessors' Association included in Attachment F to the initial statement of reasons, much less establish that there are pervasive errors throughout the data.

Moreover, the hypothetical "depreciation" example discussed on page 12 of Ms. Reheis-Boyd's letter and the attachment to the letter is overly simplistic and, as a result, it exaggerates the overall effect of understating fixture depreciation (as measured by subtracting fair market value from adjusted base year value) when determining the difference between valuing a petroleum refinery's land, improvements, and fixtures as part of the same appraisal unit, and valuing the refinery's fixtures as a separate appraisal unit. This is because the example assumes that there is sufficient land appreciation to offset all of the fixture depreciation when land and fixtures are valued as part of the same appraisal unit. However, the extent of land and improvement appreciation varies from refinery to refinery. A refinery would have to have more appreciation in its land and improvements (as measured by fair market value minus adjusted base year value), than it has "assessor-determined" depreciation in its fixtures for an understatement of the assessor-determined depreciation to have any tax effect. And, the extent of the additional appreciation in the refinery's land and improvements, if any, would limit the tax effect of understating the assessor-determined depreciation.

For example, Refineries H and I in Attachment F to the initial statement of reasons both had assessor-determined depreciation in their fixtures for 2013. However, neither refinery had appreciation in its land and improvements for 2013. So, there was no difference in the values of the refineries when their land, improvements, and fixtures were valued as one appraisal unit or their fixtures were valued as a separate appraisal unit

for 2013. And, if Refinery H's and I's fixture depreciation was double or quadrupled for 2013, it would lower the total values of the refineries and the refineries' taxes, by the same amounts, regardless of whether the refineries' land, improvements, and fixtures were valued as one appraisal unit or their fixtures were valued as a separate appraisal unit for 2013. So, the hypothetical "depreciation" example in Ms. Reheis-Boyd's letter does not accurately convey the tax effect of understating the assessor-determined depreciation when determining the difference between valuing a petroleum refinery's land, improvements, and fixtures as part of the same appraisal unit, and valuing the refinery's fixtures as a separate appraisal unit.

Mr. Walt Turville's Testimony on Behalf of Chevron

Mr. Walt Turville, Senior Property Tax Representative for Chevron, appeared at the public hearing on December 18, 2014, and provided the following testimony opposing the Board's re-adoption of Rule 474:

> I'm trying to appeal to the Board's sensibilities as -- you know, in the name of the State Board of Equalization is the word "equalization" which . . . you're charged with protecting taxpayers' rights throughout the land of California, to make sure they're treated equally and fairly under the law.
>
> Well, 474 on its face simply is stripping away one taxpayer's group's right for protection under Prop 13. And I -- I can't understand why that would even be something you'd want to do in the sense of equalization throughout all taxpayers.
>
> So the assessors already have the opportunity to value property -- or refineries as a whole, as if bought and sold. They already do the cost approach, the income approach and the sales/market approach. And in doing so, they -- they value as one unit anyway.
>
> It all comes down to how that value [gets] to the roll. And 461 was promulgated years ago and gives them a road map of how to do that and make sure that each taxpayer, each refinery, gets that Prop 13 protection.
>
> And specifically, especially on land and improvements which deserve to have that protection. 474 strips that away. And, to me, that just seems grossly unfair, and I appeal to your sensibilities as a Board to not allow that to happen and not promulgate a rule that really isn't necessary to allow the assessors to value a refinery as a whole.
>
> They always do. They always have. It's how it gets to the roll, how it gets -- value gets allocated back to the roll. And 461 tells them how to do that and how to do that fairly. And I appeal to you to ask them to -- to actually take that approach with refinery valuations.

Response to Mr. Turville's Testimony on Behalf of Chevron

The Board agrees with the California Supreme Court that Rule 474 is consistent with existing California law, including article XIII A of the California Constitution and the RTC, and that valuing a petroleum refinery's fixtures, separate from its land and improvements under Rule 461(e) sometimes results in fictitious tax windfall. Therefore, the Board does not agree with Mr. Turville that it is necessarily "fair" to apply Rule 461(e) to petroleum refinery property or that it is somehow "unfair" to re-adopt Rule 474 or that the re-adoption of Rule 474 strips away the protections of Proposition 13, which are incorporated into article XIII A of the California Constitution and the RTC, or that the adoption of Rule 474 is unnecessary.

No Mandate on Local Agencies or School Districts

The Board has determined that the re-adoption of Rule 474 does not impose a mandate on local agencies or school districts.

Determinations Regarding Alternatives

Ms. Reheis-Boyd's letter and Mr. Becker's and Mr. Turville's testimony opposed the adoption of Rule 474, but did not identify any alternative to adopting Rule 474 that would effectively accomplish the objective of the rule. Therefore, no reasonable alternatives have been identified and brought to the Board's attention that would lessen any adverse impact the proposed action may have on small business, be more effective in carrying out the purposes for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

As a result, by its motion on December 18, 2014, the Board determined that no alternative to the proposed re-adoption of Rule 474 would be more effective in carrying out the purpose for which the rule is proposed, would be as effective and less burdensome to affected private persons than the re-adopted rule, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provisions of law.

The Board did not reject any reasonable alternatives to the proposed re-adoption of Rule 474 that would lessen any adverse impact the proposed amendments may have on small business.